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MEDICAID PROVIDERS THAT CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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MEDICAID PROVIDERS THAT CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT

WEDNESDAY, NOVEMBER 14, 2007

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 3:38 p.m., in Room SD–342, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin and Coleman.

Staff Present: Elise J. Bean, Staff Director and Chief Counsel; Mary D. Robertson, Chief Clerk; Audrey Ellerbee, Congressional Fellow to Senator Levin; Mark L. Greenblatt, Staff Director and Chief Counsel to the Minority; Jay Jennings, Senior Investigator to the Minority; Sharon Beth Kristal, Counsel to the Minority; Alan Kahn, Law Clerk; Jonathan Port, Intern; Peg Gustafson and Jonathan Scanlon (Senator McCaskill); Adam Pullano, Intern; and Andrew McKechnie (Senator Coleman).

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Good afternoon, everybody. Today's hearing is the fifth in a series before this Subcommittee on Federal contractors who get paid with taxpayer dollars but fail to pay their taxes. Prior hearings have exposed as tax delinquents over 100,000 defense and civilian contractors and Medicare service providers who collectively owe billions in unpaid taxes.

The spotlight today is on the Medicaid program, in particular on the doctors, nursing homes, and other medical providers who get paid with taxpayer dollars through Medicaid, but have failed to meet their tax obligations. A review of just seven States has identified nearly 30,000 Medicaid providers who collectively owe delinquent taxes that date as far back as 10 years, and which collectively exceed $1 billion. Most of these unpaid taxes consist of payroll taxes that the Medicaid providers withheld from their employees' paychecks but did not remit to the Federal Government, and that is a crime.

Medicaid is a key Federal program that helps fund health care for America's poor. The vast majority of physicians and companies who participate in the Medicaid program are true public servants who deserve our admiration and gratitude. But a small portion of

Medicaid providers are benefiting from the program while taking advantage of honest taxpayers. These Medicaid providers are putting taxpayer dollars in their pockets with one hand, while using the other to stiff Uncle Sam by not paying their taxes.

Federal programs exist to stop this type of abuse. One key program is the Federal Payment Levy Program, which was established about 10 years ago to enable the Federal Government to identify Federal payments being made to tax delinquents and to authorize the withholding of a portion of those payments to apply to the person's tax debt.

Last year, the tax levy program collected a total of about $343 million in unpaid taxes from all types of Federal programs; only $47 million, or less than 15 percent, came from Federal contract payments. In light of the billions of dollars in unpaid taxes owed by Federal contractors, $47 million is still far, far too low. More needs to be done to cut the red tape hindering the tax levy program.

The tax delinquents we are tackling today are the tax dodgers taking advantage of the Medicaid program. Last year, the Subcommittee asked the Government Accountability Office (GAO) to estimate the number of Medicaid providers with unpaid taxes.[1] The GAO examined records in seven states that together account for roughly 40 percent of the total Medicaid contract dollars spent by the Federal Government each year. In those seven States, by comparing Medicaid payment records to the IRS list of delinquent taxpayers, the GAO was able to identify about 30,000 medical providers, about 5 percent of the total number of Medicaid providers in those States, whose unpaid taxes were about $1 billion.

In addition, the GAO identified 25 examples of blatant tax dodging, each of which involved a medical service provider who received at least $100,000 in Medicaid payments last year. The GAO identified one physician, for example, who owes over $300,000 in unpaid Federal taxes and claims "limited ability to pay taxes." That is his claim. Yet the GAO was able to determine that this same physician owns residential property worth over $1 million, received over $100,000 in Medicaid payments last year, and also received tens of thousands of dollars in Medicare payments.

In another instance, the GAO identified a nursing home that owes approximately $2 million in back taxes, but received 2006 Medicaid payments totaling $6 million. The same nursing home has also been cited by the State for jeopardizing the health and safety of its patients. A third example involves a dentist who received $200,000 in Medicaid payments last year but who has not made any Federal tax payments in several years.

The GAO also determined that not a single Medicaid tax delinquent has had a single Medicaid payment screened under the tax levy program. When we asked why, we learned that the entire Medicaid program—all $185 billion paid by the Federal Government last year—is exempt from the tax levy program because Medicaid payments are not considered "Federal payments." And the tax levy program, as of right now, is authorized to withhold funds only from "Federal payments." There is no provision in the law for tax

[1] See Exhibit 1, which appears in the Appendix on page 66.

levies to be applied to payments that are a mix of Federal and State dollars, which is what Medicaid payments are.

So one of the questions that we would like to examine today is: In light of the tax dodging going on by providers who receive payments from the Medicaid program, could the tax levy law be amended to allow the Federal Government to attach a portion of Medicaid payments that are being made to tax delinquents? And we would like to look at whatever solutions might be available to that problem.

I hope that the agencies that are gathered here today—the GAO, the IRS, FMS and CMS—will lend us their expertise to help analyze the problem and identify possible solutions.

Again, the vast majority of Medicaid providers are law-abiding citizens who pay their taxes on time. In too many cases, these honest and hard-working providers have to compete against a small number of Medicaid providers who actually gain a competitive edge by not paying or by delaying payment on their taxes. It is long past time to find a way to withhold Medicaid payments from those providers who are shortchanging the very taxpayers who are supplying their paychecks and, thereby, forcing taxpayers who pay their taxes on time to shoulder the taxes that they—the people who are not paying their taxes—are shirking. We need to figure out how to enlist the tax levy program to stop these abuses.

Senator Coleman got the ball rolling on these hearings into tax delinquent Federal contractors, and this series of hearings is a result of that effort. We commend him for that, and we commend our staffs who have always worked closely together on this issue and all the other issues we work on, and we thank them for their efforts as well.

Senator LEVIN. Senator Coleman.

OPENING STATEMENT OF SENATOR COLEMAN

Senator COLEMAN. Thank you, Mr. Chairman, and I want to start at the outset by thanking you for holding this hearing. This Subcommittee has focused on the issue of tax cheats and those who avoid their tax obligations because all the rest in the end who are paying our taxes, are living by following the rules, we pay a price for that. And so I want to thank the Chairman and his staff. Our staffs have worked together, and it has been the hallmark of this Subcommittee, and so I start by expressing my appreciation.

Today we turn our attention to a disturbing problem: Medicaid providers that are cheating on their taxes. We did Medicare last time. As the Chairman has indicated, at our request GAO examined whether Medicaid providers are cheating on their taxes. The results of their report came back and found that more than 30,000 Medicaid providers owe back taxes of more than $1 billion.[1] That is with a "b" and 9 zeros behind the number. To make matters worse, that estimate understates the problem because GAO's analysis only covered seven States, which represented only 43 percent of Medicaid expenditures. So the potential is actually much, much larger—potentially twice as much, 60,000 providers, could owe $2 billion in unpaid Federal taxes.

[1] See Exhibit 1, which appears in the Appendix on page 66.

These are not your everyday tax cheats. For starters, they receive billions of dollars every year from the Federal Government. In one case, a facility received $39 million from Medicaid in 2006 alone. So even though they make a good portion of their living from the Federal Government, they refuse to pay their fair share of taxes. It adds insult to injury that these tax deadbeats are actually paid enormous amounts of money every year from American tax coffers. They are truly biting the hand that feeds them.

Even worse, they are abusing their employees. The report finds that 56 percent of the unpaid taxes are payroll taxes. So keep in mind that payroll taxes include withholdings from their employees' wages for Social Security, Medicare, and individual income taxes. These providers, like all employers, hold this money in trust for their employees and are required to forward it to the IRS. Rather than following the law after collecting the money, these providers diverted the money for their own personal gain. Many of the owners of these businesses used their employees' payroll taxes to buy luxury cars, boats, and multi-million-dollar properties and homes, even though they owed hundreds of thousands—if not millions—of dollars in unpaid taxes. What is more, GAO's study revealed that Medicaid providers also owe more than $100 million in other debts, such as child support, student loans, and State tax debts.

The Chairman mentioned a couple cases. I will mention just two others.

One was a nursing home facility that received more than $39 million in Medicaid payments in fiscal year 2006, even though it owes more than $16 million in taxes. The majority of that tax debt is payroll taxes. The business was fined for quality-of-care violations just a couple of years ago. One of its executives withdrew more than $100,000 in cash at casinos at the same time he was not paying the nursing home's taxes. Multi-million-dollar Federal and State tax liens are outstanding against this business.

Perhaps the most egregious illustration is a nursing home business that received $25 million in payments in 2006 and owed more that $14 million in back taxes. Court documents reveal that while the business owed this tremendous tax debt, the owner of the business bought a 10,000-square-foot home worth more than $2 million and spent tens of thousands of dollars on crystal chandeliers, a 132-piece set of fine Bavarian china, and oriental rugs. The owner used the business's money to pay for a housekeeper, a nanny, monthly payments to a parent who did not work for the company, a sailboat, and jet skis. And we are not done yet. The report also showed that the owner enjoyed gambling trips to Las Vegas and Reno. And, in fact, on one of these trips, he purchased a $16,000 Rolex on the day before a required Federal tax payment was due and not paid.

Unfortunately, these are just the tip of the iceberg. This report establishes that there are thousands and thousands of other tax cheats just like them in the Medicaid program. I will repeat what the Chairman said. To be clear, this is not an indictment of all Medicaid providers or of the Medicaid program as a whole. The vast majority of Medicaid providers are honorable, law-abiding businesses that are helping the Nation's underserved communities. We appreciate their service and admire their dedication. They are

actually put at a competitive disadvantage by tax cheats who get away without living up to paying their tax obligations.

But there is a multi-billion-dollar problem here. In a time requiring fiscal discipline, these billions could be put towards our homeland security, our children's education, job training programs, or a host of other programs that serve America's needs. If the Federal Government levied the Medicaid payments in these seven States alone, we could recoup up to $160 million a year. Levying payments all over the United States might recover hundreds of millions in back taxes. Even for the Federal Government, that is a substantial sum of money.

Our hearing today will examine the scope of the problem and how we can address it. We have found over the course of the Subcommittee's investigation that there is no easy fix to this problem. The Medicaid payment mechanism is complex, and serious legal obstacles stand in the way. But we have been down this road before. Over the course of our 4-year inquiry into tax delinquent Federal contractors, we—along with the Federal Contractor Tax Compliance Task Force—have overcome numerous seemingly insurmountable hurdles. The task force has worked with this Subcommittee to resolve several thorny problems that inhibit the Federal Payment Levy Program, and it is continuing its work on a number of additional problems. I appreciate their diligence and I applaud their success. I call upon the task force—specifically the IRS, FMS, and CMS—to study this issue and recommend changes that would recover unpaid taxes from Medicaid payments. I ask for their commitment to work together and with this Subcommittee to fix the problem. In light of our collective ability to overcome serious problems in the past and the success achieved to date, I am confident we can work together to solve these thorny problems once and for all.

As we move forward, however, I would like to publicly express my concern that this Subcommittee has not received full cooperation from CMS. In July, Acting Administrator Kerry Weems said that increased oversight would be the hallmark of his tenure at CMS. In fact, I believe he stated at one of his confirmation hearings, "If confirmed, I will intensify CMS oversight and I expect you to hold me responsible."

Well, the proof is in the pudding, and I ask CMS to live up to Mr. Weems's goals. Throughout our investigations, CMS' assistance can be described—and I think it is a fair description—as "begrudging" at best. On several occasions, CMS has treated bipartisan requests from this Subcommittee as Freedom of Information Act applications. Requests from GAO, on behalf of this Subcommittee, have been met at times with resistance and uncooperative behavior. We have had numerous other problems that have hindered and delayed the Subcommittee's efforts. In short, we really do need to do better.

In fact, this morning CMS challenged GAO's report, saying, "We believe that the stated goals of this investigation were based on misconceptions about the authority and responsibilities of the Medicaid program." Make no mistake. The goal of this investigation is clear: To identify tax abuse among government providers and fix the problem. GAO and this Subcommittee have a clear under-

standing of this issue. We understand its complexity. We recognize that there are intricate legal obstacles. We recognize that there are technical and procedural hurdles to overcome.

But at the same time, we recognize that Federal providers and contractors should not be given a free pass on their tax obligations—whether they are contractors for DOD or providers of Medicare. Thousands of Medicaid providers should not be exempt from paying their taxes. The government has a unique opportunity to levy payments to these providers before they are made, and it is incumbent on us to figure out the most efficient and effective way of doing it without undermining quality of care. And I believe the two goals are not inconsistent, that we can provide quality of care and at the same time folks can live up to their tax obligations.

I think it is important to understand that what we are doing affects the quality of care for our most vulnerable citizens because the report suggests that outstanding tax debt may be an indicator of low-quality medical care. The 5 percent of providers who cheat on their taxes frequently have other problems, such as health care-related violations. It is not in the interest of the poor to have low-quality providers in the Medicaid system. Therefore, rather than undermining Medicaid, identifying these tax cheats could strengthen the system.

I reiterate my call for CMS to work cooperatively with the IRS and FMS to find a resolution to this problem. I look forward to reviewing your collective recommendations. If legislative changes are needed, we will consider them; if the Federal Government may need to assist the States in order to get their participation in the continuous levy program, we will evaluate that as well. Again, the goal is to improve the functioning of our government, and we need CMS to be a productive and willing partner in that effort.

I look forward to the testimony of today's witnesses. Thank you, Mr. Chairman.

[The prepared statement of Senator Coleman follows:]

OPENING STATEMENT OF SENATOR COLEMAN

Good afternoon and welcome to today's hearing. At the outset, I would like to commend our Chairman, Senator Levin, for holding this hearing. Like all of the Subcommittee's investigations, this has been a bipartisan effort every step along the way. I appreciate your support throughout this investigation.

Today, we turn our attention to a disturbing problem—Medicaid providers that are cheating on their taxes. At our request, GAO examined whether Medicaid providers are cheating on their taxes and found that more than 30,000 Medicaid providers owe back-taxes of more than $1 billion. To make matters worse, that estimate understates the problem because GAO's analysis covered only seven States, which represented only 43 percent of Medicaid expenditures. So, the problem is actually much, much larger—potentially as many as 60,000 providers owe $2 billion in unpaid Federal taxes.

These are not your everyday tax-cheats. For starters, they receive billions of dollars every year from the Federal Government—one of these deadbeats received $39 million from Medicaid in 2006 alone. Even though they make their living from the Federal Government, they refuse to pay their fair share of taxes. It adds insult to injury that these tax deadbeats are actually paid enormous amounts of money every year from American tax coffers. They are truly biting the hand that feeds them.

Even worse, they are abusing their employees. The report finds that 56 percent of the unpaid taxes are payroll taxes. Keep in mind that payroll taxes include withholdings from their employees' wages for Social Security, Medicare, and individual income taxes. These providers, like all employers, hold this money in trust for their employees and are required to forward them to the IRS. Rather than following the law, however, these providers diverted the money for their own personal

gain. Many of the owners of these businesses used their employees' payroll taxes to buy luxury cars, boats, and multi-million dollar properties and homes, even though they owed hundreds of thousands—if not millions—of dollars in unpaid taxes. What's more, GAO's study also revealed that Medicaid providers also owe more than $100 million in other debts, such as child support, student loans, and State tax debts.

To get a sense of the problem, let's review a couple of troubling cases:

- One nursing home facility received more than $39 million in Medicaid payments in fiscal year 2006, even though it owes more than $16 million in taxes. The majority of that tax debt is payroll taxes. The business was fined for quality of care violations just a couple of years ago. One of its executives withdrew more than $100,000 in cash at casinos at the same time he was not paying the nursing home's taxes. Multi-million dollar Federal and State tax liens are outstanding against the business.

- Perhaps the most egregious illustration is a nursing home business received $25 million in payments in 2006 and owed more that $14 million in back taxes. Court documents reveal that, while the business owed this tremendous tax debt, the owner of the business bought a 10,000-square foot home worth more than $2 million and spent tens of thousands on crystal chandeliers, 132-piece set of fine Bavarian china, and oriental rugs. The owner also used the business's money to pay for a housekeeper, a nanny, monthly payments to a parent who did not work for the company, a sailboat and jet-skis. And we're not done yet—the owner also enjoyed gambling trips to Las Vegas and Reno and went on vacations to Hawaii. During this trip to Hawaii, the owner purchased a $16,000 Rolex on the day before a required Federal payment was due.

Unfortunately, these are just the tip of the iceberg—this report establishes that there are thousands and thousands of other tax-cheats just like them in the Medicaid program. To be clear, this hearing is not an indictment of all Medicaid providers or of the Medicaid program as a whole. The vast majority of Medicaid providers are honorable, law-abiding businesses that are helping the Nation's underserved communities; we appreciate their service and admire their dedication.

But there is a $2 billion problem here. In a time requiring strict fiscal discipline, these billions could be put towards our homeland security, our children's education, job training programs, or a host of other programs that serve America's needs. If the Federal Government levied the Medicaid payments in those seven States alone, we could recoup up to $160 million every year. Levying payments all over the United States might recover hundreds of millions in back taxes. Even for the Federal Government, that is a substantial sum of money.

Our hearing today will examine the scope of the problem and how we can address it. We have found over the course of the Subcommittee's investigation that there is no easy fix to this problem—the Medicaid payment mechanism is complex and serious legal obstacles stand in our way. But we have been down this road before. Over the course of our 4-year inquiry into tax-delinquent Federal contractors, we—along with the Federal Contractor Tax Compliance Task Force—have overcome numerous seemingly insurmountable hurdles. The Task Force has worked with this Subcommittee to resolve several thorny problems that inhibit the Federal Payment Levy Program and it is continuing its work on a number of additional problems. I appreciate their diligence and I applaud their success. I call upon the Task Force—specifically, the IRS, FMS, and CMS—to study this issue and recommend changes that would recover unpaid taxes from Medicaid payments. I ask for their commitment to work together and with this Subcommittee to fix the problem. In light of our collective ability to overcome serious problems in the past and the success achieved to date, I am confident we can work together to solve these thorny problems as well.

As we move forward, however, I would like to publicly express my concern that this Subcommittee has not received full cooperation from CMS. In July, Acting Administrator Kerry Weems said that increased oversight would be hallmark of his tenure at CMS. In fact, I believe he stated at one of his confirmation hearings "If confirmed, I will intensify CMS oversight and I expect you to hold me responsible." Well, the proof is in the pudding, and I ask CMS to live up to Mr. Weems's goals. Throughout our investigations, CMS's assistance has been begrudging at best. For example, on several occasions, CMS has treated bipartisan requests from this Subcommittee as FOIA applications. Requests from GAO, on behalf of this Subcommittee, have been met with resistance and uncooperative behavior. We have had numerous other problems that have hindered and delayed the Subcommittee's efforts. In short, we need to do better.

In fact, CMS this morning challenged GAO's report, saying "we believe that the stated goals of this investigation were based on misconceptions about the authority and responsibilities of the Medicaid program." Make no mistake: the goal of this investigation is clear—to identify tax abuse among government providers and fix the problem. GAO and this Subcommittee have a clear understanding of the issue; we understand its complexity. We recognize that there are intricate legal obstacles. We recognize that there are technical and procedural hurdles to overcome.

But at the same time, we recognize that Federal providers and contractors should not be given a free pass on their tax obligations—whether they are contractors for DOD or providers in Medicare. Thousands of Medicaid providers should not be exempt from paying their taxes. The government has a unique opportunity to levy payments to these providers before they are made and it is incumbent on us to figure out the most efficient and effective way of doing so.

We also recognize that this affects the quality of medical care for our most vulnerable citizens; the evidence suggests that outstanding tax debt may be an indicator of low-quality medical care. The 5 percent of providers who cheat on their taxes frequently have other problems, such as health care-related violations. It is not in the interest of the poor to have low-quality providers in the Medicaid system. Therefore, rather than undermining Medicaid, identifying these tax-cheats could strengthen it.

I reiterate my call for CMS to work cooperatively with the IRS and FMS to find a resolution to this problem. I look forward to reviewing your collective recommendations. If legislative changes are needed, we will consider them; if the Federal Government may need to assist the States in order to get their participation in the continuous levy program, we will evaluate that as well. Again, the goal is to improve the functioning of our government and we need CMS to be a productive and willing partner in that effort.

I look forward to the testimony of our witnesses.

Senator LEVIN. Thank you very much, Senator Coleman.

Let me now welcome our panel of witnesses for this afternoon's hearing: Gregory Kutz, Managing Director of the Forensic Audits and Special Investigations Unit at the Government Accountability Office; Linda Stiff, the Acting Commissioner of the Internal Revenue Service; Kenneth Papaj, the Commissioner of the Financial Management Service at the Department of the Treasury; and Dennis Smith, Director of the Center for Medicaid & State Operations at the Centers for Medicare and Medicaid Services at the Department of Health and Human Services.

We appreciate all of your being with us this afternoon. We look forward to your testimony.

Pursuant to Rule VI, all witnesses who testify before this Subcommittee are required to be sworn, and at this time I would ask all of you to please stand and raise your right hand. Do you swear that the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. KUTZ. I do.

Ms. STIFF. I do.

Mr. PAPAJ. I do.

Mr. SMITH. I do.

Senator LEVIN. Thank you.

We will be using a timing system today. Approximately 1 minute before the red light comes on, you will see the light change from green to yellow, giving you an opportunity to conclude your remarks. The written testimony of each of you will be printed in the record in its entirety. We ask that you limit your oral testimony to no more than 5 minutes.

Mr. Kutz, we will have you go first, followed by Ms. Stiff, Mr. Papaj, and then Mr. Smith. After we have heard all of your testimony, we will turn to questions. So, Mr. Kutz, welcome.

TESTIMONY OF GREGORY D. KUTZ,[1] MANAGING DIRECTOR, FORENSIC AUDITS AND SPECIAL INVESTIGATIONS UNIT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KUTZ. Mr. Chairman and Ranking Member Coleman, thank you for the opportunity to discuss Medicaid providers with tax problems.

In March, I testified that Medicare physicians and other suppliers were abusing the Federal tax system with little or no consequence. At your request, we have expanded our investigation of tax abuse to Medicaid providers. My testimony has two parts: First I will discuss our findings and, second, key policy and program issues.

First, we found that over 30,000, or 5 percent, of Medicaid providers in seven States had over $1 billion of delinquent Federal taxes. These seven States represent about 43 percent of total Medicaid disbursements. To put a face on this issue, as you mentioned, we investigated 25 Medicaid cases from these seven States. For all 25 cases, we found abusive and criminal activity related to the Federal tax system. Seventeen of these cases were businesses with unpaid payroll taxes. As you both mentioned, willful failure to remit payroll taxes to the IRS is a felony.

For 2006, these 25 providers received $88 million of Medicaid payments while at the same time having $52 million of delinquent Federal taxes. Many of these individuals accumulated substantial personal wealth, in part due to Medicaid, at the same time they failed to pay their Federal taxes. The posterboard shows examples of some of the homes and luxury vehicles owned by these individuals.[2]

In addition to these 25 cases, we separately found the owner of a nursing home that was recently convicted for payroll tax fraud. This business received $25 million of Medicaid payments while at the same time having $14 million of delinquent Federal taxes.

As Senator Coleman mentioned, at the same time this individual failed to pay payroll taxes, they bought a 10,000-square-foot home for over $2 million and a $16,000 Rolex watch one day before the payroll tax deposit was due.

Our current and past investigations have shown that failure to pay Federal taxes is not the only problem these individuals have. Let me use the posterboard to walk you through four other themes from our cases.[3]

First, as Senator Coleman mentioned, inadequate medical care. We found patient abuse, quality-of-care violations, and a number of malpractice lawsuits.

Second, substantial other debt. Sixteen of our cases had State tax debt, and others had unpaid or delinquent student loans and other Federal debts.

Third, criminal activity. Several individuals were convicted of larceny and income tax evasion. Others were investigated for money laundering, mail fraud, and cocaine possession.

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[1] The prepared statement of Mr. Kutz with attachments appears in the Appendix on page 27.
[2] The chart referred to by Mr. Kutz appears in the Appendix on page 42.
[3] The chart referred to by Mr. Kutz appears in the Appendix on page 43.

And, fourth, suspicious cash transactions. Several individuals had large cash transactions, including one individual with well over $100,000 of gambling transactions.

These outrageous cases lead to my second point. What is being done about tax frauds that are operating in the Medicaid program? Unfortunately, the answer to that is nothing. Federal law does not prohibit providers with unpaid taxes from enrolling in or billing Medicaid.

In a written response to our report, CMS expressed concerns about the tone and language of our report and implications that they have any responsibility or authority to screen providers for tax debt. Our report clearly states that CMS is not required to do anything. However, we are concerned that fraudsters like the ones I just mentioned are currently operating within the Medicaid program. We believe that Congress, CMS, and the States should consider options to prevent the more egregious cases I discussed from participating in Medicaid. All options should ensure Medicaid participants are not harmed. Ridding Medicaid of the 26 fraud cases that I have described would be a positive step for program integrity.

At the back end of the process, we have the levy process, which was mentioned by both Senator Levin and Senator Coleman. We estimate that for fiscal year 2006, an effective, continuous tax levy would have resulted in the collection of between $70 and $160 million of delinquent Federal taxes for these seven States. To date, there has been no continuous levy of Medicaid in any States, and, again, Senator Coleman, you mentioned that was because IRS has determined that these are not Federal payments—a key requirement for the levy program.

In conclusion, the good news is that the vast majority of Medicaid providers pay their Federal taxes. However, our work has shown that thousands of these providers have taken advantage of the opportunity to avoid paying over $1 billion of Federal taxes. Our case studies show the enrichment of tax fraudsters being bankrolled by State and Federal Medicaid payments. Isn't it ironic that a program designed to provide health care to the poor is actually being used to line the pockets of these tax fraudsters?

Senator Coleman, this ends my statement. I look forward to your questions.

Senator COLEMAN [presiding]. Thank you, Mr. Kutz. Ms. Stiff.

TESTIMONY OF LINDA STIFF,[1] ACTING COMMISSIONER, INTERNAL REVENUE SERVICE, U.S. DEPARTMENT OF THE TREASURY

Ms. STIFF. Good afternoon, Chairman Levin, Ranking Member Coleman, and Members of the Subcommittee. I am pleased to update you on the progress we have made since your hearing last March on the Medicare issue, as well as to discuss the possibility of including Medicaid providers in the continuous levy program. I also want to thank this Subcommittee for its continued interest in the broad issue of using the Federal Payment Levy Program (FPLP) as a means of collecting tax debt. I am pleased to report

[1] The prepared statement of Ms. Stiff appears in the Appendix on page 44.

that total revenue collected through the FPLP has increased from $89 million in fiscal year 2003 to $345 million in fiscal year 2007, nearly a four-fold increase. Much of the progress we have made in the past 4 years has been the direct result of the interest and support of the Subcommittee Members and its staff.

During the hearing last March, we explained that we had just determined that payments to Medicare providers were indeed Federal payments for the purposes of the FPLP, and that we were beginning to work with the CMS and the FMS to determine how to bring these providers under the continuous levy program.

CMS joined the Federal Contractor Tax Compliance Task Force to assist in the development of a pilot program to incorporate Medicare provider payments into the FPLP. That pilot program is tentatively scheduled to go into operation in 2008 and will levy Medicare payments disbursed through CMS' centralized accounting system. This is a systemic process whereby FMS will match information about CMS' payments, on a daily basis, against the tax debts included in the FPLP. FMS will provide information back to CMS when there was a match, and CMS will levy the payments.

We are on track to implement the matching process in 2008 for contractors that are currently utilizing the CMS system. We anticipate full and complete implementation during fiscal year 2011.

Also at the March hearing, GAO referred to us 40 cases with evidence that certain Medicare providers may be guilty of abusive and/or potentially criminal activity relative to Federal income and/or employment taxes. My written statement provides a detailed report on the progress we have made in dealing with these cases.

On track with the latest GAO investigation that is the subject of this hearing, the task force has now sought to determine if payments to Medicaid providers might also be included in the FPLP. Unfortunately, we have been advised by Counsel that the FPLP, as currently structured is not a tool that can be used to collect payments made by States to Medicaid providers. Counsel weighed various factors relating to the structure and operation of the Medicaid program, concluding that the payments do not meet the criteria established to be considered Federal payments. This means that we must use alternative enforcement tools to pursue Medicaid providers that are delinquent on their taxes.

After this hearing, GAO will refer to us 25 additional cases that it discovered in its audit. We will review these cases carefully and take appropriate action, as we have on the previous cases which GAO referred to us. However, I would note that a cursory review of these 25 cases, based on the information provided in the GAO report, indicates that the taxpayers involved in these cases are not strangers to IRS enforcement. The profile of each of these providers confirms that the IRS has sought enforcement actions against virtually all of them. In some cases, that action involved a lien against the provider or an effort to apply the Trust Fund Recovery Penalty. In some cases, the provider was part of the FPLP levy, although not for Medicaid payments.

I would be remiss if I did not mention one final issue that certainly has an impact on our ability to deal with these issues. It is critical that the IRS' fiscal year 2008 budget request be fully fund-

ed. We need those resources to continue our efforts in the very areas we are discussing here today.

Thank you again, Mr. Chairman, for your efforts and for the opportunity to be here this afternoon. I will be happy to respond to any questions that you may have.

Senator COLEMAN. Thank you, Ms. Stiff. Mr. Papaj.

TESTIMONY OF KENNETH R. PAPAJ,[1] COMMISSIONER, FINANCIAL MANAGEMENT SERVICE, U.S. DEPARTMENT OF THE TREASURY

Mr. PAPAJ. Thank you, Chairman Levin, Ranking Member Coleman, and Subcommittee Members. Thank you for inviting me here to testify today. I am pleased to have this opportunity to report on the success of the FMS' debt collection program and our recent accomplishments and ongoing plans to further improve the Federal Payment Levy Program. I would like to thank the Members of this Subcommittee and your staffs for your continuing interest in and support of these important efforts.

FMS operates a government-wide debt collection program that collects both tax and non-tax debts owed to Federal agencies and certain debts owed to States. I am pleased to report that in fiscal year 2007, the program brought in record-breaking collections of $3.76 billion, $1.7 billion of which was for child support. Of the $3.76 billion, Federal tax debt collections totaled approximately $345 million, an increase of $42 million, or 14 percent, over fiscal year 2006 collections. As shown on the attached chart,[2] collections have shown a steady rise over the last 4 years. And since the inception of the program in 1996, we have collected over $31.5 billion in delinquent debt that would otherwise not have been collected.

With regard to Federal contractors who owe delinquent taxes, the number of levies against Federal vendor payments increased in fiscal year 2007 by 11 percent. Collections from Federal contractors totaled $47.4 million in 2007 and over $1.1 billion in tax debts have been collected since the inception of the levy program. And this number reflects only the collections received directly through FMS' Federal Payment Levy Program.

Notwithstanding these record collections, we realize there is always room for improvement, and we strive to achieve that.

Since the last Subcommittee meeting in March, significant developments have taken place. First, we have added additional payment types to the program. In June of this year we added payments issued by the Army Corp of Engineers to both the offset and levy programs. In October, FMS began offsetting Railroad Retirement Board payments with $844,000 collected in the first 2 months. We will soon add those payments to the levy program once programming changes are complete. In August, we implemented a process to ensure that delinquent taxpayers are not able to bypass the levy process by receiving Federal payments via Fedwire, which is a same-day payment mechanism. Delinquent taxpayers are now blocked from receiving Fedwire payments and must receive their payment through another mechanism that is subject to levy.

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[1] The prepared statement of Mr. Papaj with an attachment appears in the Appendix on page 53.

[2] The chart referred to by Mr. Papaj appears in the Appendix on page 57.

Next, we have put in place reciprocal agreements with the States of Maryland and New Jersey to collect each other's debt. Since offsets began in July, we have collected $11.8 million of debt owed to Maryland and New Jersey, and those two States have collected $439,000 of debt owed to the Federal Government.

Additionally, we continue to work with IRS to increase the number and dollar amount of tax debt that is activated for levy. The amount of tax debts activated for levy has increased from $53.1 billion in fiscal year 2006 to $62.7 billion in fiscal year 2007. This represents about 51 percent of the tax debt IRS has referred and is an increase of 6 percent from fiscal year 2006. To increase this number even further, the Administration has proposed a legislative change that would allow IRS to forego the due process that is currently required prior to levy and allow instead for post levy due process under certain circumstances. We believe this would be particularly helpful in ensuring that we do not miss the opportunity to levy payments to contractors which are often one-time, non-recurring payments.

We also continue to work to ensure that payments from various systems used for making payments to contractors are subject to levy. The latest system to be added, known as the Automated Clearing House-Corporate Trade Exchange system, is on target for implementation by the end of December.

We are ready to conduct testing with the U.S. Postal Service to incorporate their payments into the levy program, and we are on target for full implementation by the end of this year.

At the March hearing, this Subcommittee brought to light the important issue of Medicare providers who owe significant amounts of tax debt, yet continue to receive payments from the Federal Government. At that time, we committed to working with the IRS and CMS to find a solution. Since that time, much progress has been made toward implementing a pilot program to levy Medicare payments. Staffs from all three agencies participate in a subgroup of the Federal Contractor Tax Compliance Task Force formed to meet this challenge. FMS and CMS recently participated in a table-top exercise which walked through the proposed process for matching CMS payment records with records of delinquent taxpayers and levying those payments when appropriate.

While the idea of collecting overdue taxes from Medicare providers is relatively straightforward, it is an enormously complex undertaking involving a significant number of systems and interfaces. Nevertheless, as a result of the commitment and dedication of the agencies and the support of this Subcommittee, the pilot program to levy Medicare payments is expected to begin in October 2008. In the interim, the task force is working to develop a manual process whereby FMS could provide information to IRS on specific Medicare providers who owe taxes so that IRS can issue paper levies. More detail regarding the accomplishments of the task force will be included in a written report to the Subcommittee early next year.[1]

You specifically asked me to address issues surrounding the levy of Medicaid payments in response to recent GAO findings on Med-

[1] See Exhibit 2, which appears in the Appendix on page 105.

icaid providers who owe delinquent taxes. Unlike Medicare payments which are disbursed by the Federal Government, Medicaid payments to providers are issued by the States. This introduces additional legal and operational complexities not present under Medicare. The task force has already begun examining the issue of incorporating these payments into the levy program. Recently, the IRS has determined that such payments are not Federal payments subject to continuous levy under the current law. Nevertheless, FMS, along with IRS and CMS, will continue to examine the issue on how best to overcome existing legal hurdles and ensure that any process to levy payments is operationally feasible and not unduly burdensome and costly to the Federal Government or to the States. We expect this to be a complex and long-term effort. However, in the interim, because of the overlap between Medicare and Medicaid providers, we are optimistic that progress can be made toward reducing the tax obligations of Medicaid providers through our efforts to implement a process to levy Medicare payments next year.

This concludes my statement. I would be happy to respond to any questions.

Senator LEVIN [presiding]. Thank you, Mr. Papaj. Mr. Smith.

TESTIMONY OF DENNIS G. SMITH,[1] DIRECTOR, CENTER FOR MEDICAID & STATE OPERATIONS, CENTERS FOR MEDICARE AND MEDICAID SERVICES, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. SMITH. Thank you, Mr. Chairman, Senator Coleman. It is a pleasure to be with you this afternoon to discuss Medicaid's relationship to the Federal Payment Levy Program. In fiscal year 2008, Medicaid will pay approximately $345 billion to hundreds of thousands of health care providers and plans including hospitals, nursing homes, physicians, and even taxicabs to provide health care services to about 50 million Americans. The Federal share of that amount is approximately $190 billion.

Medicaid is administered by the States, and many Medicaid providers contract directly with those States. The States are the ones who enroll the providers into the program. We, at the Federal level, in contrast to Medicare, in Medicaid we do not enroll providers, we do not pay providers directly. Our relationship is reimbursing the States. The States are the ones who undertake those administrative functions, and in terms of future discussions, I would suggest that we invite our partners, the States, to participate in any of the potential solutions that we might bring to bear.

As stated previously, there has been work done in the most recent weeks prior to the hearing to examine the issue of whether or not Medicaid would qualify under the levy program. We do not believe that Medicaid does, that it does not qualify as a Federal payment. So I think there is the issue in the first place of the statutory limitations that we have.

Obviously, we cannot prevent someone who has not lived up to their obligations under the law to pay their taxes. We cannot take action against someone that we do not know about, whether that

[1] The prepared statement of Mr. Smith appears in the Appendix on page 58.

is preventing them from enrolling in the program in the first place or by offsetting payments to them through the Medicaid program.

There is a fair amount of overlap between Medicare and Medicaid, and oftentimes providers participate in both programs. But Medicaid in many respects goes well beyond the universe of Medicare. Medicaid reimburses for things that Medicare does not, very few other payers do not. Other payers generally are not paying taxicabs to help people with disabilities to get to their doctor's appointments, for example. We pay home and community-based services, oftentimes by community-based organizations, many of them governmental, many of them not-for-profit, and some for-profit. Some of those payers are not even—the payments are not made through the automatic claims processing system. So there would be significant funds that are disbursed by States to people who are not even paid through the automated system, so that would miss claims collections as well.

And I think on the State side of things, having run a State Medicaid program and helped bring up a new MMIS system, States will rightfully ask if this is a responsibility outside the Medicaid program. States are rightly going to want to be paid fully for the cost of participating in that system.

There are various capabilities across the States and territories in terms of their systems' capabilities. You have States in wide variation in terms of platforms that they are using. Some process in-house with State staff. Some are completely hired contractors, vendors such as EDS or ACS, who are running those systems on behalf of the States. So, again, there would be another level of—again, in terms of protecting taxpayer information, yet another level of involvement for people who actually run the systems on the States.

And as I said, the States themselves are in various degrees of capacity. We have States that are bringing up new systems, States that are not fully integrated themselves, and States that run multiple systems. A large State like California, for example, is running multiple systems.

So to bring all of those players into the fold would require, I think, significant resources to even start putting edits into a system, to systems that, as I understand, have been described to me as what Medicare is now doing on their side with the levy program, having that level of interface between these systems, it would not be unreasonable to estimate it would cost at least a couple of million dollars per State per system to be able to make those interfaces work.

Let me conclude there, and I would be delighted to answer any questions.

Senator LEVIN. Thank you, Mr. Smith. Thank you all.

Let me start with you, Mr. Kutz, about how we would design a system where you could levy Medicaid payments. CMS, as everyone has stated, does not make direct payments to Medicaid service providers, does not keep track of who the providers are. So one possible first step would be to have CMS create a national registry of Medicaid service providers, requiring them to fill out an enrollment form similar to the ones that CMS now requires Medicare providers to complete. The form would have to ask providers for their taxpayer identification number, and for their consent to having

CMS get tax debt information from the IRS. Is that accurate so far?

Mr. KUTZ. I believe so.

Senator LEVIN. What would be, in your judgment, the cost and administrative burden involved in developing that form, creating a national registry, and keeping it updated?

Mr. KUTZ. I really cannot answer how much that would cost. Certainly it would take some time. One thing that is relevant to this also, the seven States that we looked at, which are five of the biggest—I think the five biggest, actually, along with two other ones that were near our headquarters and field offices, those States represented to us—and we did not audit this or investigate this—that they do have their own continuous levy programs over State payments for their own debts. So somehow tapping into that possibly is a way to do it for at least the bigger States. So I can speak to that. Again, we did not determine what that entails, but there seemed to be some promise in that.

Senator LEVIN. All right. Well, let's go back to that, and then I will go to Mr. Smith and ask him what would be involved in having a new registry. On asking the States to do it on the ground that many of them now have a levy program for their own tax deficiencies, how many States, approximately, have some kind of a withholding system, a levy system on outgoing State funds to collect back State taxes? Do you know?

Mr. KUTZ. I can only speak to the seven. It was broader than taxes. It was any State debt. So they had it similar to the TOP program here in the Federal Government; it was broader than just State taxes.

Senator LEVIN. Did you ask those States what would be involved if they broadened their program in order to collect Federal debt and presumably got some kind of a payment for doing that?

Mr. KUTZ. No, we did not.

Senator LEVIN. Do you have an assessment as to how difficult it would be? Are you familiar enough with any of those States' collection systems?

Mr. KUTZ. No. We just wanted to see if it was feasible to operate a continuous levy program at that level by asking them. We did not go beyond to validate what they told us.

Senator LEVIN. Which is that they have such a system.

Mr. KUTZ. They have them, yes. But we did not validate what the details were behind that or how difficult it would be. We wanted to see if it was feasible at that level, which obviously at the Federal level could be more complicated, but, again, at their level they were operating that.

Senator LEVIN. And did you ask them at all their opinion about the practicality of collecting Federal taxes that were due?

Mr. KUTZ. I do not believe so.

Senator LEVIN. So you have no idea of costs or complications. Do you know whether Congress would have to amend the law in order to allow States to get taxpayer information from the IRS or FMS, and then to screen and to levy the Medicaid payments?

Mr. KUTZ. Well, they could do it by getting a waiver of consent by the actual providers. So that is one way to do it without the

change in the law; otherwise, you would potentially have to allow it by law.

Senator LEVIN. All right. So we could ask them to collect these debts and then ask them to get waivers signed.

Mr. KUTZ. To check with IRS, yes, that is correct. If they signed a waiver as part of their enrollment or being in the program, they could actually do that, I believe.

Senator LEVIN. Is it within your work orbit to check with those—was it seven States?

Mr. KUTZ. Seven States that represent 43 percent of Medicaid disbursements.

Senator LEVIN. Would it be appropriate to ask you to check with those seven States——

Mr. KUTZ. We could certainly do that for you, yes.[1]

Senator LEVIN [continuing]. To see how much work it would be for them to go through that waiver process and then to collect and then to charge the Federal Government a portion of what they collect?

Mr. KUTZ. We could inquire on that, and certainly we could feed that into the task force, who is looking at the Federal level at the feasibility and see if there are any matches or anything that makes sense.

Senator LEVIN. All right. If you would do that and let the Subcommittee know what the response was of the seven States.

Now, let me go to you, Mr. Smith. What is your reaction to either that system, that possibility, or to create a national registry the way it apparently has been done for Medicare?

Mr. SMITH. Mr. Chairman, we have not looked at that as an issue. Clearly, there are hundreds of thousands of providers who participate in the Medicaid program. They also participate in ones that the individual who owes the tax liability is actually never identified because you might be an individual doctor working in a group practice, for example. So it is the group that is enrolled as the Medicaid provider, so you would not find the individual liability in that respect.

Senator LEVIN. Is that true with Medicare as well?

Mr. SMITH. I believe that would be true as well, yes, sir.

Senator LEVIN. Has that been a problem?

Mr. SMITH. I do not know to what extent they have encountered that issue.

Senator LEVIN. How many Medicare providers are there? Medicare first, then Medicaid.

Mr. SMITH. Medicare, I do not—1 million Medicare providers. I believe there would be at least that many Medicaid, but although many of those would also overlap. A hospital, a nursing home, probably is participating in both. But as I said, there are also lots of Medicaid providers who are not Medicare providers, because we provide services beyond that.

In terms of stopping someone from enrolling as a provider because they have a tax liability, clearly that would be one approach to it. Then, as I understand the levy program to work, you are withholding payment, as I understand it, up to 15 percent of what-

[1] See Exhibit 3, which appears in the Appendix on page 108.

ever payment. Payments to providers generally are made on a biweekly basis, so each State is running their claims as they are paying providers, so every time you are paying, you are also making an adjustment in reducing the amount of money that provider is due.

That is done on an ongoing basis, so that would be more than just the one time stopping you from enrolling because you have a tax liability.

Senator LEVIN. Is there a form right now that Medicaid requires providers to fill out?

Mr. SMITH. Yes, sir. States requires providers to—when they do enroll their providers, they do various levels of qualifying, credentialing, professional licenses, as well as the tax identification, etc.

Senator LEVIN. Is that a Federal form or a State form?

Mr. SMITH. States would have their own forms of how they enroll them, and, again, because each State runs their own management information system, it is going to be unique to have that system be able to take in that type of information and have it automated.

Senator LEVIN. And that form, is that made available to the Federal Government?

Mr. SMITH. We certainly could ask the States for it.

Senator LEVIN. But you do not get them routinely?

Mr. SMITH. Not routinely, as I said, because the States are actually doing the enrollment.

Senator LEVIN. Well, they do the enrollment, but is there any information from those forms that you routinely obtain?

Mr. SMITH. Not on a routine basis.

Senator LEVIN. Survey information or other information?

Mr. SMITH. We could collect that, Mr. Chairman, but routinely it would not come to us.

Senator LEVIN. And can you tell this Subcommittee for the record how large a problem you think it would be for you to ask the States to obtain waivers for you?

Mr. SMITH. Again, I think the States would be asking for the waiver from the individual. It is the provider who has to waive their right for them to be able to have that information.

Senator LEVIN. Can you, for the record, tell this Subcommittee how difficult it would be for you to ask all the States in their forms, for the taxpayer information and to tell Medicaid providers that by participating in the program they are waiving their right to have that information withheld from you folks? Will you tell us for the record? Unless you can tell us right now. Does that sound like a big deal to you?

Mr. SMITH. I do not think it is. We certainly can ask the States to do that, if I understand that is what the request is.

Senator LEVIN. You do not think that would be a big deal?

Mr. SMITH. We could do that.

Senator LEVIN. OK. Thank you. Senator Coleman.

Senator COLEMAN. Thank you, Mr. Chairman.

First, I do want to express my appreciation for the progress that has been made in Medicare, and my sense is that presented a number of complexities. Mr. Papaj, in your testimony you talk about a one-day test match with CMS, matching Medicare Parts A and B

payments with the Healthcare Integrated General Ledger Accountant System, HIGLAS, and you indicate in your testimony just with one day with the tax debts and the Federal Payment Levy Program, when activated for a levy, it resulted in 335 matches with potential collections of $1.1 million. So there is work being done, and you are making progress working with CMS and IRS to say we could be collecting money in the Medicare program. And I think it is fair to say it is a complicated program. You would not disagree with that assessment?

Mr. PAPAJ. No. Medicaid is certainly more complicated than the Medicare program.

Senator COLEMAN. In regard to Medicaid, what we are talking about here is the continuous levy, and so one of the technical problems, Mr. Smith, as has been indicated, is that States do not qualify as—they are not agents of the Federal Government by the nature of being a State. Is that what the legal bar is, that we are dealing with States that are not agents of the Federal Government? Is that why we cannot—I am not talking about the technical side, just the legal side. Is that the barrier there? Ms. Stiff.

Ms. STIFF. Yes, our legal counsel has looked at what would constitute a Federal payment, and in a nutshell, there are three factors that are contributing to the analysis that these do not qualify as legal payments. The first is the flow of funds, meaning that the States are actually making the payments to the providers. Second, the relationship between the State and the providers, and the States actually establish the criteria and the thresholds for eligibility to participate. They render the decisions on whether the claims are to be allowed or disallowed. Third, in the event of a dispute over the payment or the non-payment by the provider, the State is the responsible party, not the Federal Government.

Senator COLEMAN. Correct me if I am wrong, but the IRS can currently levy Medicaid payments. Is that correct, through a paper levy?

Ms. STIFF. Yes, we do it through the paper levy, which is a little bit different process.

Senator COLEMAN. But you can levy Medicaid payments.

Ms. STIFF. Yes, we can.

Senator COLEMAN. Payments made by the State, but the difference is a paper levy.

Ms. STIFF. The paper levy process allows us to levy what is before us today. It does not call for the continuous levy against the next payment and the next payment to capture the full amount.

Senator COLEMAN. So the levies are essentially—what is it—a 30-day levy?

Ms. STIFF. One day.

Senator COLEMAN. Hypothetically, could it be a 60-day levy? Could it be 90 days?

Ms. STIFF. We would need to review that and see if we need a statutory, regulatory, or procedural change on that.

Senator COLEMAN. Do you have any objection from the States in terms of using the paper levy? Does that create any problems in terms of the relationship with the States?

Ms. STIFF. No. I think the issue that constraints the paper levy is the fact that it is a one-time event as opposed to getting every payment that comes their way in the future.

Senator COLEMAN. And, again, I am just going to——

Ms. STIFF. We will look at that.

Senator COLEMAN. We can levy payments, so the issue really is using a Federal program that would provide for a continuous levy, again, understanding that there are significant hurdles. My concern is that we know there are hurdles. We know there are hurdles with Medicare where folks got together, with some resistance. Mr. Smith, I know you were not part of it, I do not believe, personally involved in the Medicare trouble. I think you are a Medicaid person, right? You are not a Medicare person.

Mr. SMITH. Correct. I am Medicaid.

Senator COLEMAN. But, Mr. Kutz, I will turn to you. Is it fair to say that we had difficulty with CMS in terms of getting information and getting it when it was requested?

Mr. KUTZ. Yes, I would say that.

Senator COLEMAN. And so what I am looking for is recognizing the challenges but understanding that, in fact, we do levy payments, that we can do it in a micro sense. I would hope that we would pull together—by the way, Mr. Smith, you made a good recommendation. Bring the States into the discussion. I think they should be part of the solution.

But, clearly, paper levies are not, Ms. Stiff, the most effective way to collect unpaid taxes. Is that a fair statement?

Ms. STIFF. Well, they are not ineffective. It is just that when you have this recurring income stream, the paper levy constrains your ability to capture against the future earnings.

Senator COLEMAN. Mr. Kutz, if I can, just in terms of the size of the problem, you have looked at seven States, and that constituted what percentage of the total of Medicaid payments?

Mr. KUTZ. Forty-three percent, Senator.

Senator COLEMAN. Maybe it is too simplistic to say a doubling, but we looked at less than half of the transactions that are being conducted with Medicaid. Is that correct?

Mr. KUTZ. Correct.

Senator COLEMAN. And as Mr. Smith indicated, there is some overlap even of the cases that you looked at?

Mr. KUTZ. There were 2,000 cases that we discussed in March of Medicare physicians and other suppliers that were in our 30,000 for today's study.

Senator COLEMAN. In your testimony you talked about the range of other problems that the individuals who were scofflaws, who were tax deadbeats, and you kind of went through a litany. I am trying to figure out would it be fair to say that a failure to pay tax debt could be a marker in terms of health care providers who have other problems or, perhaps even more importantly, are not providing quality health services? Did you see a correlation there?

Mr. KUTZ. Again, we did not do a statistical sample, a broad study, but certainly our work overall has shown that people who are tax fraudsters for decades, that is not the only issue they have got. And with respect to the Medicare cases we did in March and the ones for Medicaid today, they did have an unusually high pre-

ponderance of other criminal activity, health care violations, suspicious activity reports, strange cash transactions going on. So these are—at least the egregious cases—professional fraud cases.

Senator COLEMAN. And would it be fair to say that we saw the same patterns when we looked at defense and civilian contractors who were not paying their taxes, when we looked at GSA contractors who were not paying taxes, and when we looked at Medicare? In all your investigations we have been involved in, at least my recollection is that we have found similar patterns. Is that a fair statement?

Mr. KUTZ. There are hundreds of cases in the similar patterns, yes.

Senator COLEMAN. One of the concerns, Mr. Smith—and I want to make sure that we are not undermining the ability to provide service. The nice thing about a levy system is keeping folks providing service. You are just making sure that as we are paying them, we are holding back a percentage of that payment so that they are paying their obligations. And I am not sure how you do this, but I would hope that you would be screening or looking at the issue of quality service. Is that fair, that CMS does look at the quality of service?

Mr. SMITH. Certainly, Senator, and we have under my Center, we have the survey and certification responsibility also. So if there is a quality-of-care issue in a nursing home or a hospital and the GAO has referrals to us, we absolutely have other ways to deal with people who are endangering the lives and health of the people that we serve.

Senator COLEMAN. And then just a last question——

Mr. KUTZ. Senator, could I mention one thing?

Senator COLEMAN. Yes, Mr. Kutz.

Mr. KUTZ. One of the problems we have is we cannot refer these cases to CMS. We can only refer them to IRS, and that gets into the law on the sharing of tax information, 6103. So that is an important point here. We would love to be able to share these 25 cases with CMS, but we cannot by law.

Senator COLEMAN. One of the things, Mr. Chairman, that I am going to ask the entire panel to do is to go back and to look at the existing system and to spend a little time, identify the challenges and the bars to effectively utilizing the Federal payment levy system in dealing with Medicaid, if there are issues with the States, issues with funding. Mr. Smith, you have indicated it may cost $100 million. We are talking about half the cases returning $160 million in 1 year. That may be 1 year's cost, if it is the cost. But my request to this panel is for FMS and CMS and IRS to go back and put your heads together, and for GAO to be involved in that discussion, and let us know what is it that we have to do on the legal side, on the definition of what a Federal entity is, etc., and in a way that makes sense, makes good common sense. I think if you do that, it would be a tremendous service, and it would be a service to all the taxpayers of this Nation.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you, Senator Coleman.

Let me make that request in another way. I think it is the same request, essentially, but basically, each of you, what would you rec-

ommend—first your top recommendation, second recommendation, third recommendation—to increase Federal tax levy collections? I think that is what Senator Coleman's question is. If you want to get together and make those recommendations jointly, fine. But I would say that within 30 days we would like those recommendations. Can each of you give us recommendations of that kind within 30 days? Mr. Kutz.

Mr. KUTZ. Yes.[1]

Senator LEVIN. Ms. Stiff.

Ms. STIFF. Yes.[2]

Senator LEVIN. OK. Mr. Papaj.

Mr. PAPAJ. We will try to do so.[2]

Mr. SMITH. I would be happy to, Mr. Chairman.

Senator LEVIN. OK. Thank you.

We have a vote on now, which I think we have about 6 minutes left to make any comments. I would just ask a couple questions here, and we will recess.

Do you have additional questions?

Senator COLEMAN. I will go vote and then come back.

Senator LEVIN. So we will put this hearing in recess for your additional questions. OK. I just have a couple additional questions, and then I will leave.

This, I think, is for you, Mr. Smith. Is there a standard, a rule, a procedure that you have that says that medical service providers who have outstanding tax debts are ineligible to participate in the Medicaid program?

Mr. SMITH. I do not believe there is such a thing, and, again, Mr. Chairman, the issue for us is we do not know who has a tax——

Senator LEVIN. No, I understand that. What I am asking is that if you have a standard which says that if you have a tax debt, you are ineligible to participate? You may not know who is lying to you, but on your application or your provider's form, you would have a statement, "the undersigned has no outstanding tax debt." I am not saying you would know who is lying, but it would be a false statement to a Federal agency for them to say they do not have a tax debt if they do. And there would be some people who might be reluctant to lie to a Federal agency in order to participate in the program, since that is illegal.

Mr. SMITH. Again, Mr. Chairman, the States are the ones who would be enrolling the providers, so they would not be making a statement to a Federal official.

Senator LEVIN. Fair enough. Do any of the States, do you know, have that statement that they ask their providers to make?

Mr. SMITH. I am not aware, Mr. Chairman, but there very well may be. I would have to check. I do not believe we had such a provision in Virginia when I ran Virginia Medicaid.

Mr. KUTZ. Mr. Chairman, I understand, my staff has told me, that California may have such a provision, and we could certainly——

Senator LEVIN. Could you check that out?

Mr. KUTZ [continuing]. Check that out for you, yes.

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[1] See Exhibit 3, which appears in the Appendix on page 108.
[2] See Exhibit 2, which appears in the Appendix on page 105.

Senator LEVIN. Would you have any problem, Mr. Smith, or would your agency have any problem requiring States to add a representation on the application of the provider that the provider has no outstanding Federal tax debt?

Mr. SMITH. Mr. Chairman, I would have to talk with counsel to see if that would be allowable. The Medicaid statute itself has certain provisions, and if we could require it—I would not have any problem with requiring it if we have the authority.

Senator LEVIN. Would you let us know if you have any problem with that?

Mr. SMITH. I would be happy to, Mr. Chairman.[1]

Senator LEVIN. All right. There was some discussion here, Ms. Stiff, about the paper levies. Can you change the expiration date on the paper levies—is that doable—without changing law or regulation?

Ms. STIFF. I do not know. I am going to have to go back and verify that.

Senator LEVIN. Would you let us know about that as well?

Ms. STIFF. I will.

Senator LEVIN. OK. We are going to stand in recess until one or more of my colleagues comes back. I am not going to be able to come back, so let me thank you for your testimony.

We will stand in recess probably for no more than 5 minutes, but until a Senator comes and picks up this gavel, we are in recess.

[Recess.]

Senator COLEMAN [presiding]. This hearing is reconvened. I have a few more follow-up questions.

Mr. Papaj, as I was looking at the charts of collections, it appears that collections declined for 2007, declined from $59.6 million in 2006 to $47.4 million in 2007. Can you help me understand the reason for the decline?

Mr. PAPAJ. I think the key point is even though the dollar amounts went down, the number of levies that——

Senator COLEMAN. And these are contractor collections, right?

Mr. PAPAJ. Right. The number of payments that we received for the levy actually increased 11 percent, and we cannot control the dollar amount of the payments. But what I think is important is that we continue to get the stream of payments that we can do the levies on, and that continues to show an increase.

Senator COLEMAN. And I am wondering—and I would turn to Ms. Stiff—do we have any sense that Federal contractors are settling up with the IRS? In other words, they know the system is in place and——

Ms. STIFF. Yes, sir.

Senator COLEMAN. Is there some sense that is happening, Ms. Stiff?

Ms. STIFF. Yes, sir, on two fronts. Let me add on to what Mr. Papaj just said.

On the decline from almost $56 million down to the $48 million, I think there are two factors contributing to that. One was that in the prior year there were several large payments that were kind

[1] See Exhibit 4, which appears in the Appendix on page 115.

of anomalies and are not repeating themselves as opposed to an actual decline.

Senator COLEMAN. A $6 million payment by one DOD contractor in 2006. Is that correct?

Ms. STIFF. Yes, sir. And I think those anomalies are contributing to that decrease.

Senator COLEMAN. Are folks settling up? Is there a sense——

Ms. STIFF. Yes, sir.

Senator COLEMAN [continuing]. That you are seeing more settling up with kind of the entire debt rather than getting involved where you are going to have some levy imposed against you and whatever stigma attaches with that?

Ms. STIFF. We implemented the FPLP program in fiscal year 2000, and I believe that we reported to you today that we have collected a little over $1 billion through that process. It is interesting to note that we send a Notice of Intent to Levy to taxpayers that go into this program on the front end. Since that same time frame, we have collected just under $1 million from taxpayers who did exactly what you are talking about, which is to settle up as a result of the Notice of Intent to Levy.

Senator COLEMAN. And one of the reasons I raise the question, it goes to the request from the Chairman and the request that I offered for folks here to come back with—to figure out a way for us to do it. There is no question but that there is money out there. Some folks, if you put the system in place or give people the opportunity to settle up, we are going to benefit. There are going to be more dollars coming in that people owe. We are not taking cash out of their pockets that they do not owe. They have obligations here that they have not lived up to.

Let me ask a question about criminal prosecution. There is no question IRS has aggressively pursued tax cheats from a collection standpoint. Can you talk to me a little bit, Ms. Stiff, about the philosophy involved in criminal prosecution? And the question is raised—and perhaps it was Mr. Kutz in some of our conversations. You have referred, what, 122 cases to the IRS? Is that a correct number?

Mr. KUTZ. No. If you count all of the different tax-related ones we have done, it is probably 250 or 300.

Senator COLEMAN. And how many of those have been followed up with criminal prosecution, do you know?

Mr. KUTZ. I think the IRS would have to answer. I am not aware of any prosecutions related to those referrals.

Senator COLEMAN. Ms. Stiff.

Ms. STIFF. We have established a special process to deal with all the referrals that have come from GAO over the course of the hearings and their investigations on the FPLP program. Each and every one of those cases has been reviewed or is being reviewed, in some instances by our Criminal Investigative Division. A full review of the facts, the circumstances, and analysis to determine if criminal prosecutions are merited—I can get you the numbers for the record. I do not have the exact number. I do not know the number off the top of my head. Probably fewer than a dozen that have actually been followed through on.

Senator COLEMAN. Is there a line that is drawn or can you help me understand some of the factors that go into determining whether something moves from being a civil collection, an outlandish abuse of failing to pay obligations? At what point does it kind of move into the criminal realm?

Ms. STIFF. Well, I think as we all know, the bar for criminal prosecution is set much higher. Certainly before someone wants to take a case into court, it needs to have some jury appeal; given the facts and circumstances, they need to believe they have a case they can win.

In many of these cases, we have instances where taxpayers have subsequently gone out of business. We have many instances where they have subsequently gone bankrupt. We have many instances where they actually make payments sporadically and then do not, which would cause a jury in a court proceeding to determine that those were actually bad business decisions as opposed to a matter of criminal intent.

So there are a number of factors when you actually get behind some of these cases that make it difficult to sustain criminal indictment and prosecution.

Senator COLEMAN. I understand, Mr. Papaj, that you are going to be retiring.

Mr. PAPAJ. Yes, Senator.

Senator COLEMAN. I will take this opportunity on the record to thank you for your efforts. I think we have made tremendous progress in this area from when we first started, and we understand the complicated nature of what we are trying to accomplish. But the benefit for the taxpayer is just so enormous, there is a mother lode of dollars out there where the obligation is clear, is absolutely clear, and the ability to collect is at hand because we are still paying these folks. So this is not a cash flow issue. This is not somebody who cannot afford to pay. We are paying them at a time that they have obligations, significant obligations.

So the challenge we have is to put in place a system whereby we could use something like the levy process, and I just want to express my appreciation for your service and working in partnership with the other agencies and figuring out a better way to do this. I was looking at some of the numbers. DOD, from where we started, I think $700,000 with Federal defense contractors collected in the levy system, and in fiscal year 2006, I think it is about $31 million. That is over a 4,000-percent increase, I think systemwide, with some figures that have shown over an 800-percent increase in collections.

So what we can do is we can set it up, and with the work of Mr. Kutz and his associates at GAO, but ultimately folks have to work the system. I will end on this note.

But, again, Mr. Smith, you were not involved in Medicare. That was complicated, and there is a sense from this Senator's perspective that we did not get the kind of response from CMS originally that we are going to work and we are going to figure this out. It just seemed like we were pulling teeth.

I will tell one quick story. Thomas Jefferson, the Virginia countryside during the time when he was President, he was with a bunch of other friends traveling on horseback, and they came to a

portion of a river where there is no bridge, and so they cannot go across a bridge. They have to wade across. And as they are wading across, one by one the party goes across. The President is the last guy to go, and there is a guy standing on the side there with a big bundle of goods. And everyone proceeds. The last guy left is the President. As he is about to get on his horse, the guy goes up to the President and says, "Excuse me. Can you help me get across?" And Jefferson says, "Absolutely." And he kind of repositions himself, and they get across the river. And when they come to the other side, one of the guys in Jefferson's party goes, "The President says"—he goes up to this guy, and he is outraged at this guy. And he says, "Who do you think you are? That was the President of the United States and you asked him to carry you across the river? You could have asked any one of us, but you asked the President." And the guy's response was, "Well, I am sorry. I did not know who he was. But I looked at all your faces, and they said no. And I looked at his face, and it said yes."

And what I am looking for is a face that says yes. In spite of all the challenges and the complexities, if we say we can figure out a way to do this without undermining the system, without limiting or lessening the quality of care, without burdening States—and I am a former mayor, a local elected official. I am deeply concerned about unfunded mandates. But I really think we have within ourselves the capacity to say yes and to figure this out. We have come a long way, and we will continue marching down this path. But we need everyone's cooperation.

So I look forward to that cooperation. I appreciate the good work that CMS does. I recognize the challenge they have.

Mr. Papaj, we will continue on without you, but hopefully your successor will carry your face that says yes into the fray and into the conversation.

Mr. PAPAJ. Thank you, Senator, and thanks for the support of the Subcommittee and the staff. It has been a great run, and I think what we need is to work together to be innovative, to be creative, and to try to find solutions.

Senator COLEMAN. Thank you.

With that, this hearing is adjourned. I will for the record note that we will keep the record open for 2 weeks, plus we expect to have a report back from the witnesses within 30 days.

[Whereupon, at 5:18 p.m., the Subcommittee was adjourned.]

APPENDIX

United States Government Accountability Office

GAO

Testimony

Before the Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate

For Release on Delivery
Expected at 2:30 p.m. EST
Wednesday, November 14, 2007

MEDICAID

Thousands of Medicaid Providers Abuse the Federal Tax System

Statement of Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations

GAO-08-239T

November 2007

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-08-239T, a testimony before the Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

In fiscal year 2006, outlays for Medicaid were about $324 billion; about $185 billion was paid by the federal government. Because GAO previously identified abusive and criminal activity associated with government contractors owing billions of dollars in federal taxes, the subcommittee requested GAO expand our work to Medicare and Medicaid providers. Today's testimony covers Medicaid providers who abused the federal tax system from 7 selected states.

GAO was asked to (1) determine if Medicaid providers have unpaid federal taxes, and the magnitude of such debts; (2) identify examples of Medicaid providers that have engaged in abusive or related criminal activities; and (3) determine whether the Centers for Medicare & Medicaid Services (CMS) and the states prevent health care providers with tax problems from enrolling in Medicaid or participating in the continuous levy program to pay federal tax debts. To perform this work, GAO analyzed tax data from the Internal Revenue Service (IRS) and Medicaid data from seven selected states and performed investigative activities.

What GAO Recommends

GAO's related report (GAO-08-17), released today, recommended IRS determine whether Medicaid payments can be included in the continuous levy program and evaluate the 25 cases GAO identified for additional collection and criminal investigation. IRS agreed with our recommendations.

To view the full product, including the scope and methodology, click on GAO-08-239T. For more information, contact Greg Kutz at (202) 512-6722 or kutzg@gao.gov.

MEDICAID

Thousands of Medicaid Providers Abuse the Federal Tax System

What GAO Found

Over 30,000 Medicaid providers, about 5 percent of those paid in fiscal year 2006, had over $1 billion of unpaid federal taxes. These 30,000 providers were identified from a nonrepresentative selection of providers from seven states: California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas. This $1 billion estimate is understated because some Medicaid providers may have understated their income or not filed their tax returns.

We selected 25 Medicaid providers with high federal tax debt as case studies for more in-depth investigation of the extent and nature of abuse and related criminal activity. For all 25 cases we found abusive and related criminal activity, including failure to remit individual income taxes or payroll taxes to IRS. Rather than fulfill their role as "trustees" of federal payroll tax funds and forward them to IRS, these providers diverted the money for other purposes. Willful failure to remit payroll taxes is a felony under U.S. law. Individuals associated with some of these providers diverted the payroll tax money for their own benefit or to help fund their businesses. Many of these individuals accumulated substantial assets, including million-dollar houses and luxury vehicles, while failing to pay their federal taxes. In addition, some case studies involved businesses that were sanctioned for substandard care of their patients. Despite their abusive and related criminal activity, these 25 providers received Medicaid payments ranging from about $100,000 to about $39 million in fiscal year 2006.

Examples of Medicaid Providers with Abusive and Related Criminal Activity

Type of business	Unpaid tax debt	Fiscal year 2006 Medicaid payments	Description of activity
Nursing home	$2 million	$6 million	Owner fined for jeopardizing health and safety of patients.
Home care	$3 million	$2 million	Business did not file tax returns in late 1990s and early 2000s.
Counselor	$200,000	$200,000	Owner indicted for fraud for several hundred thousand dollars relating to a federal program.

Source: GAO analysis of IRS, CMS, public, and other records.

CMS and our selected states do not prevent health care providers who have federal tax debts from enrolling in Medicaid. CMS officials stated that such a requirement for screening potential providers for unpaid taxes could adversely impact states' ability to provide health care to low income people. Further, federal law generally prohibits the disclosure of taxpayer data to CMS and states.

No tax debt owed by Medicaid providers has ever been collected from Medicaid payments through the continuous levy program. IRS has determined that Medicaid payments are not considered "federal payments" and thus not eligible for this program. GAO estimates that for the seven selected states the federal government could have collected between $70 million to $160 million during fiscal year 2006 if an effective levy program was in place.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss Medicaid health care providers from seven selected states and their adherence to the federal tax system. This testimony builds on your concern about the $290 billion annual federal tax gap. This testimony also builds on a large body of work, conducted over the past few years, much of which was requested by this Subcommittee, in which we investigated entities that have abused the federal tax system while benefiting from doing business with or receiving status from the federal government.[1] Our testimony, and the accompanying report that we are releasing today,[2] address Medicaid health care providers from seven selected states who also abused the federal tax system.

Medicaid is the largest source of funding for medical and health-related services for America's poorest people. More than 50 million persons enrolled in the Medicaid program in fiscal year 2006. Medicaid is jointly funded by the federal and state governments. In fiscal year 2006, according to Centers for Medicare & Medicaid Services (CMS), total outlays for Medicaid (federal and state) were approximately $324 billion, of which about $185 billion was paid by the federal government.

Today's testimony focuses on (1) whether providers who receive Medicaid payments from the seven selected states have unpaid federal taxes, and if so, the magnitude of federal tax debts owed by these Medicaid providers; (2) providing examples of providers engaged in abusive and criminal activity related to the federal tax system; and (3) whether CMS and selected states prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay federal tax debts.

To identify the extent to which Medicaid providers had unpaid federal taxes, we obtained and analyzed fiscal year 2006 Medicaid payments made to providers in a nonrepresentative selection of seven states:[3] California,

[1]See related GAO products at the end of this testimony.

[2]GAO, *Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System*, GAO-08-17 (Washington, D.C.: Nov. 14, 2007).

[3]There are 56 Medicaid programs, including one for each of the 50 states, the District of Columbia, Puerto Rico, American Samoa, Guam, Northern Mariana Islands, and the Virgin Islands. Hereafter, all 56 entities are referred to as states.

Colorado, Florida, Maryland, New York, Pennsylvania, and Texas.[4] We matched the lists of Medicaid providers with IRS tax debts as of September 30, 2006. To further analyze abuse of the federal tax system by selected Medicaid providers, we applied certain criteria—the amount of outstanding tax debt, and the number and age of reporting periods for which taxes were due—to select 25 providers for detailed audit and investigation. For these 25 providers, we reviewed tax records and performed additional searches of criminal, financial, and other public records.

To determine whether CMS and states prevent health care providers with unpaid federal taxes from enrolling in Medicaid, we interviewed officials from CMS and selected states and examined CMS and selected states' regulations, policies, and procedures for making determinations in the enrollment approval process. We also interviewed officials from CMS, the Internal Revenue Service (IRS), and the Department of the Treasury's Financial Management Service (FMS) concerning any barriers for levying Medicaid payments. For further details on our scope and methodology, see appendix I of the accompanying report.[5]

We conducted our audit work from July 2006 through August 2007 in accordance with U.S. generally accepted government auditing standards. We performed our related investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Summary

While the vast majority of Medicaid providers pay their fair share of taxes, thousands of Medicaid providers in seven selected states abused[6] the federal tax system with little or no consequence. Our analysis of data provided by the selected states and IRS indicates that over 30,000 Medicaid providers, over 5 percent, had tax debts totaling over $1 billion

[4]Throughout this testimony, these seven states are referred to as the selected states.

[5]GAO-08-17.

[6]We considered activity to be abusive when a Medicaid provider's actions or inactions, though not illegal, took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

as of September 30, 2006.[7] The unpaid taxes largely consisted of individual income and payroll taxes.[8] The $1 billion estimate of tax debts owed by Medicaid providers is understated because IRS data do not reflect all amounts owed by businesses and individuals. Specifically, the $1 billion estimate of tax debts owed does not include amounts owed by businesses and individuals that have not filed tax returns or that have failed to report the full amount of taxes due (referred to as nonfilers and underreporters) and for which IRS has not determined which specific tax debts are owed.

Our audit and investigative work details the nature of abusive and criminal activity related to the federal tax system by 25 Medicaid providers. These 25 providers were paid by Medicaid for a variety of services, including hospital, nursing facility, physician, and ambulance services. Payments ranged from about $100,000 to approximately $39 million during fiscal year 2006. Many were established businesses that owed federal payroll taxes withheld for their employees. Rather than fulfill their role as "trustees" of these funds and forward them to IRS as required by law, these health care providers diverted the money for other purposes. These payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes.[9]

At the same time that they were not paying their federal taxes, many individuals associated with our 25 cases bought or owned significant personal assets, including commercial properties, expensive homes, and luxury vehicles. One business officer withdrew over $100,000 in cash at casinos at the same time the business accumulated millions of dollars in federal taxes. Further, another case study business was sanctioned by its state regulator for substandard care of its patients.

[7]Because some Medicaid providers may do business with Medicare and other federal agencies, such as Veterans Affairs, some of the approximately 30,000 Medicaid providers described in this testimony may also have been included in our reports concerning the Department of Defense, General Services Administration, civilian federal contractors, Medicare Part B providers, and tax-exempt organizations that abuse the federal tax system.

[8]Payroll taxes include amounts that employers withhold from employees' wages for federal income taxes, Social Security, and Medicare as well as the related employer matching contributions for Social Security and Medicare taxes. Employers are responsible for remitting payroll taxes to IRS and are liable for any outstanding balance.

[9]Willful failure to remit payroll taxes is a criminal felony offense while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense. 26 U.S.C. §§ 7202, 7215, and 7512 (b).

CMS and the selected states do not prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid. CMS has not promulgated regulations to require states to (1) screen health care providers for unpaid taxes and (2) obtain consent for IRS disclosure of federal tax debts. CMS officials stated that the primary focus of the Medicaid program, in partnership with the states, is to provide health care services for low income people and not the administration of taxes. CMS officials stated that such a requirement could be a burden to the states in their enrollment of providers and could adversely impact states' ability to provide health care to the poor. Even if CMS did want to screen health care providers with tax debts, federal law generally prohibits the disclosure of taxpayer data to CMS and states.[10] Thus, CMS and states do not have access to tax data directly from IRS unless the taxpayer provides consent. Consequently, CMS and the selected states have no mechanism or requirement to prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid.

A provision of the Taxpayer Relief Act of 1997 authorizes IRS to continuously levy certain federal payments made to delinquent taxpayers. In response to one of our recommendations from our accompanying report,[11] IRS has determined that Medicaid payments are not considered federal payments, and thus are not subject to the continuous levy program. Thus, no tax debt owed by Medicaid providers can be collected through the continuous levy program. If there had been an effective program in place for levying Medicaid payments, we estimate that for fiscal year 2006, the selected seven states could have levied payments for the federal government and collected between $70 million to about $160 million of unpaid federal taxes.

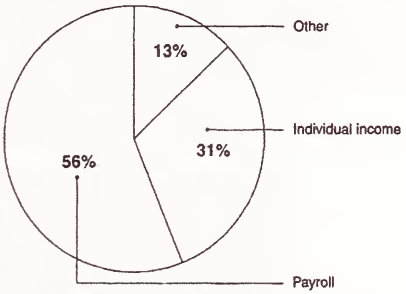
[10]States screen health care providers prior to enrollment into the Medicaid program. States also process and pay Medicaid claims and are reimbursed for the federal share of these payments by CMS.

[11]GAO-08-17.

Magnitude of Unpaid Federal Taxes of Medicaid Providers

Our analysis found that over 30,000 Medicaid providers at the selected states had over $1 billion in unpaid federal taxes as of September 30, 2006.[12] This represents over 5 percent of the approximately 560,000 Medicaid providers paid by the selected states during federal fiscal year 2006. As shown in figure 1, 87 percent of the approximately $1 billion in unpaid taxes was comprised of individual income and payroll taxes. The other 13 percent of taxes included corporate income, excise, unemployment, and other types of taxes.

Figure 1: Medicaid Providers' Unpaid Taxes by Tax Type



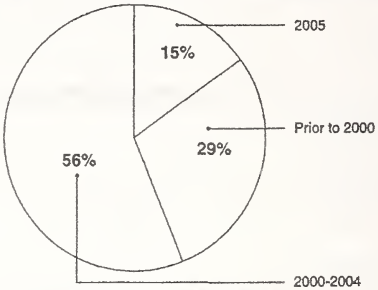
Source: GAO analysis of Medicaid and IRS data as of September 30, 2006.

A substantial amount of the unpaid federal taxes shown in IRS records as owed by Medicaid providers had been outstanding for several years. As reflected in figure 2, about 56 percent of the $1 billion in unpaid taxes was for tax periods from calendar year 2000 through calendar year 2004, and

[12]Our estimate of Medicaid providers with tax debt as of September 30, 2006, excluded (1) tax debts that have not been agreed to by the tax debtor or affirmed by the court, (2) tax debts from calendar year 2006, (3) approved Medicaid claims less than $100, and (4) tax debts less than $100.

approximately 29 percent of the unpaid taxes was for tax periods prior to calendar year 2000. [13]

Figure 2: Unpaid Taxes of Medicaid Providers by Calendar Year



Source: GAO analysis of Medicaid and IRS data as of September 30, 2006.

The amount of unpaid federal taxes reported above does not include all tax debts owed by Medicaid providers due to statutory provisions that give IRS a finite period under which it can seek to collect on unpaid taxes. There is a 10-year statute of limitations beyond which IRS is prohibited from attempting to collect tax debt.[14] Consequently, if the Medicaid providers owe federal taxes beyond the 10-year statutory collection period, the older tax debt may have been removed from IRS's records. We were unable to determine the amount of tax debt that had been removed.

Although the $1 billion in unpaid federal taxes we identified as owed by Medicaid providers as of September 30, 2006, is a significant amount, it understates the full extent of unpaid taxes. This amount does not include

[13]A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is generally one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.

[14]The 10-year time limit may be suspended and include periods during which the taxpayer is involved in a collection due process appeal, litigation, a pending offer-in-compromise, or an installment agreement. As a result, fig. 2 includes taxes that are for tax periods from more than 10 years ago.

amounts due IRS from Medicaid providers that did not file payroll taxes (nonfilers) and that underreported their payroll tax liability (underreporters). Also, we did not include Medicaid provider tax debt from 2006 tax periods, or tax debt for entities owing less than $100 or paid less than $100.

Examples of Extent and Nature of Medicaid Providers' Abusive and Criminal Activity Related to the Federal Tax System

For all 25 cases that we audited and investigated,[15] we confirmed that their activities were abusive and in many instances found criminal activity related to the federal tax system. These 25 providers were paid by Medicaid for a variety of services, including hospital, nursing facility, physician, and ambulance services. Payments ranged from about $100,000 to approximately $39 million during fiscal year 2006. In table 1, we summarize 5 of these cases. We have referred the 25 cases detailed in our accompanying report to IRS so that it can determine whether additional collection action or criminal investigation is warranted. In response to our report, IRS agreed to review our cases to determine if additional collection action or criminal investigation is needed.

[15]For these 25 cases, we obtained copies of automated tax transcripts and other tax records (for example, revenue officer's notes) from IRS and performed additional searches of criminal, financial, and public records. In cases where record searches and IRS tax transcripts indicated that the owners or officers of a business were involved in other related entities (i.e., entities that share common owner(s) or officer(s), a common TIN, or a common address) that have unpaid federal taxes, we also reviewed the related entities and the owner(s) or officer(s), in addition to the original business we identified. In instances where we identified related parties that had both Medicaid payments and tax debts, our case studies included those related entities, combining unpaid taxes and combined Medicaid payments for the original individual/business as well as all related entities. Because our investigations were generally limited to publicly available information, our audit of the 25 cases may not have identified all related parties or all significant assets (i.e., personal bank data, companies established to hide assets) that the Medicaid providers own.

Table 1: Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
1	Nursing home	$39 million	$16 million	• Business's tax debt is primarily unpaid payroll taxes. • Business fined for quality of care violations in early 2000s. • Business officer withdrew over $100,000 in cash at casinos at the same time he was not paying the nursing home's taxes. • Multimillion-dollar IRS and state tax liens filed against the business.
2	Hospital	$9 million	$5 million	• Business's tax debts are primarily composed of unpaid payroll taxes beginning in the late 1990s. • IRS reported tax debts to the continuous levy program for collection action. • IRS proposed an injunction to close the business in a recent year because the business continued to accumulate tax debt. • IRS assessed a trust fund recovery penalty (TFRP) against business owners. • IRS attempted to levy a bank account but the owner closed the account prior to the levy. • Business owners had several large cash transactions in recent years. • Owners own two residences worth over $2 million. • IRS and the state filed tax liens against the business. • Business received over $2 million in Medicare payments in a recent year.
3	Nursing home	$6 million	$2 million	• Business's federal tax debts are primarily composed of unpaid payroll taxes. • Business received nearly $2 million in Medicare payments in a recent year. • IRS reported tax debts to the continuous levy program for collection action. • Business charged with patient abuse, and business and business owner also fined and suspended for jeopardizing the health and safety of patients. • IRS filed tax liens against the business and business owner. • Related business owes over $1 million of unpaid taxes that have been referred to the continuous levy program.

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
4	Home care	$2 million	$3 million	• Business's tax debts are primarily unpaid payroll taxes beginning in the late 1990s. • Business did not file tax returns in late 1990s and early 2000s. • Business owners own multiple real properties, including a million dollar residence, luxury vehicles, and a recreational boat. • IRS assessed over $1 million TFRP against one business owner. • Business filed bankruptcy in a recent year. • IRS and state filed tax liens against the business. • Business owners own several related health care businesses which are in bankruptcy status.
5	Professional counselor	$200,000	$200,000	• Owner's tax debt is primarily individual income taxes. • Owner and spouse currently under investigation for mail fraud. • Owner has a felony conviction. • Owner indicted for fraud for several hundred thousand dollars relating to a federal program. • IRS filed tax liens against the owners.

Source: GAO's analysis of IRS, FMS, Medicaid claims, public, and other records.

Notes: Dollar amounts are rounded. The nature of unpaid taxes for businesses was primarily due to unpaid payroll taxes. A Medicaid provider can submit claims using either an employer identification number (EIN) or Social Security number (SSN). In our testimony, any provider submitting a claim with an EIN is referred to as a business, and any provider submitting a claim with an SSN is referred to as an individual.

[a]Medicaid payments are Medicaid claims paid by states for fiscal year 2006 (October 1, 2005, to September 30, 2006).

[b]Unpaid tax amount was as of September 30, 2006.

The above cases illustrate how some Medicaid providers abused the federal tax system for their own benefit. Some of these individuals bought or owned significant personal assets, including expensive homes, recreational boats and luxury vehicles. One business officer withdrew over $100,000 in cash at casinos at the same time the business owed millions of dollars in federal taxes. Further, another case study business was sanctioned by its state regulator for substandard care of its patients.

Four of the above cases involved established businesses that owed federal payroll taxes withheld for their employees. Rather than fulfill their role as "trustees" of these funds and forward them to IRS as required by law, these health care providers diverted the money for other purposes. These

payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes.[16]

Providers with Unpaid Federal Taxes Are Not Prohibited from Enrolling or Receiving Payments from Medicaid

Federal law does not prohibit providers with unpaid federal taxes from enrolling in and billing Medicaid. Federal regulations and policies require the states, as part of their responsibilities for determining whether the providers meet Medicaid requirements for enrollment, to verify basic information on potential providers, including whether the providers meet state licensure requirements and whether the providers are prohibited from participating in federal health care programs. However, federal regulations and policies do not require the states to screen these providers for federal tax delinquency, nor do they explicitly authorize the states to reject the providers that have delinquent tax debt from participation in Medicaid. CMS officials stated that the primary focus of the Medicaid program is to provide health care services for low income people and not the administration of taxes. CMS officials stated that such a requirement could be a burden to the states in their enrollment of providers and could adversely impact states' ability to provide health care to the poor. Consequently, the selected states' processes generally do not consider federal tax debts of prospective providers in the Medicaid enrollment process.[17]

Further, due to a statutory restriction on disclosure of taxpayer information, even if tax debts specifically were to be considered in enrollment in Medicaid, no coordinated or independent mechanism exists for the states to obtain complete information on providers that have unpaid tax debt. Federal law does not permit IRS to disclose taxpayer information, including tax debts, to CMS or Medicaid state officials unless the taxpayer consents, which neither CMS nor the states currently seek.[18] Thus, certain tax debt information can only be discovered from public records if IRS files a federal tax lien against the property of a tax debtor or

[16]Willful failure to remit payroll taxes is a criminal felony offense while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense. 26 U.S.C. §§ 7202, 7215, and 7512 (b).

[17]Officials from California stated that they do consider federal debts, including tax debts, if they are self-disclosed on a Medicaid application. California officials said that no verification is made.

[18]26 U.S.C. § 6103.

if a record of conviction for tax offense is publicly available.[19] Consequently, CMS and state officials do not have ready access to information on unpaid tax debts to consider in making decisions on Medicaid providers.

Although a provision of the Taxpayer Relief Act of 1997 authorizes IRS to continuously levy certain federal payments made to delinquent taxpayers, no tax debt owed by Medicaid providers has ever been collected using this provision of the law.[20] If there had been an effective levy program in place, we estimate that the selected states could have levied payments for the federal government and collected between $70 million to about $160 million of unpaid federal taxes during fiscal year 2006. In response to our recommendation to conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program, IRS has determined that Medicaid payments are not federal payments and thus not subject to the continuous levy program.[21]

Concluding Comments

Available data indicate that the vast majority of Medicaid providers appear to pay their federal taxes. However, our work has shown that over 30,000 Medicaid providers have taken advantage of the opportunity to avoid paying their federal taxes. While Medicaid providers are relied on to deliver significant medical services to those most in need, they must also pay their fair share of federal taxes. It is also important that they comply with federal tax law in order for the federal government to collect the funds to which it is entitled to finance critical government priorities, and to help improve the overall level of compliance with the nation's tax laws.

[19]Under section 6321 of the Internal Revenue Code, IRS has the authority to file a lien upon all property and rights to property, whether real or personal, of a delinquent taxpayer.

[20]To improve the collection of unpaid taxes, IRS is authorized to continuously levy up to 100 percent for federal payments related to goods and services. To implement this levy authority, IRS, in coordination with the Department of the Treasury's FMS, implemented the Federal Levy Payment Program in July 2000. This program uses FMS's Treasury Offset Program (TOP) for the levy of federal payments.

[21]In addition to the continuous levy program, IRS also has the authority to legally seize property either held by the taxpayer or owned by the taxpayer and held by a third party. This authority includes the seizure of Medicaid receivables held by states and owed to health care providers. Unlike levies from the continuous levy program, each levy is typically a one-time seizure of property (i.e., Medicaid receivables) held by states at a specific point of time and is done on a case-by-case basis based on the particular circumstances of the case. IRS officials stated that they do not know how much in tax levies were collected from Medicaid payments.

Mr. Chairman and Members of the Subcommittee, this concludes my statement. I would be pleased to answer any questions that you or other members of the committee may have at this time.

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony.

Appendix I: Related GAO Products

Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes. GAO-07-1090T. Washington, D.C.: July 24, 2007.

Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes. GAO-07-563. Washington, D.C.: June 29, 2007.

Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System. GAO-07-742T. Washington, D.C.: April 19, 2007.

Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System. GAO-07-587T. Washington, D.C.: March 20, 2007.

Internal Revenue Service: Procedural Changes Could Enhance Tax Collections. GAO-07-26. Washington, D.C.: November 15, 2006.

Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes. GAO-06-887. Washington, D.C.: July 28, 2006.

Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes. GAO-06-755T. Washington, D.C.: May 25, 2006.

Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System. GAO-06-492T. Washington, D.C.: March 14, 2006.

Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence. GAO-05-683T. Washington, D.C.: June 16, 2005.

Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence. GAO-05-637. Washington, D.C.: June 16, 2005.

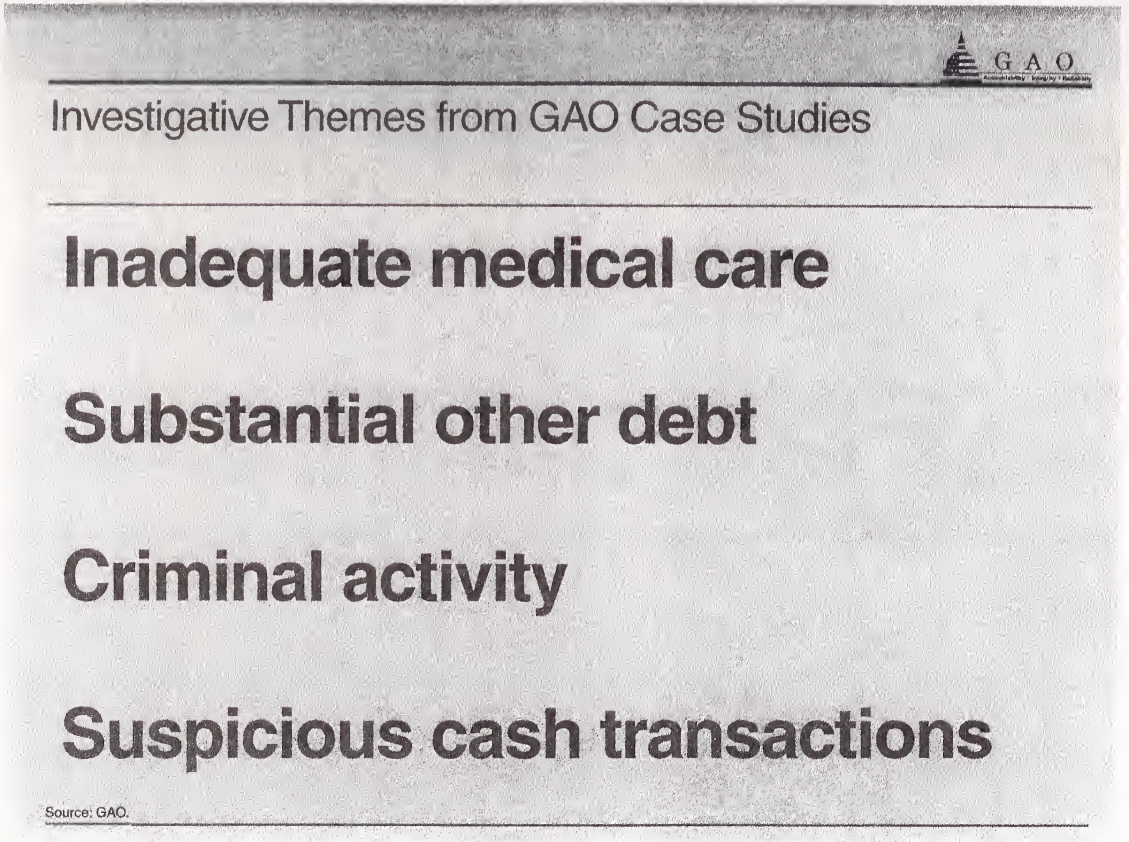
Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence. GAO-04-414T. Washington, D.C.: February 12, 2004.

Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence. GAO-04-95. Washington, D.C.: February 12, 2004.

GAO

Luxury Homes and Car Belonging to Tax Delinquent Medicaid Providers

Source: GAO.


GAO
Investigative Themes from GAO Case Studies
Inadequate medical care
Substantial other debt
Criminal activity
Suspicious cash transactions
Source: GAO.

INTERNAL REVENUE SERVICE

WRITTEN TESTIMONY
OF
LINDA STIFF
ACTING COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
MEDICAID PROVIDERS WHO CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT

NOVEMBER 14, 2007

Good afternoon Chairman Levin, Ranking Member Coleman and members of the Permanent Subcommittee on Investigations. I am pleased to appear before you to discuss Medicaid payments made to providers who may be delinquent on their Federal tax obligations and the IRS' ability to claim what is owed through the Federal Payment Levy Program (FPLP).

While this is my first opportunity to testify before the Subcommittee, the IRS has discussed issues related to FPLP with the Subcommittee on several occasions. We first appeared in 2004 to respond to the Government Accountability Office (GAO) report on 47 Department of Defense (DoD) contractors who were delinquent on their taxes. In 2005 we appeared to discuss 50 civilian contractors that the GAO had identified as also being delinquent as well as the 25 cases from the General Services Administration (GSA). At that time, we pointed out the progress that the IRS had made working with the Financial Management Service (FMS), the GSA, DoD, the Office of Management and Budget (OMB), and the Department of Justice (DOJ). Together these agencies formed the Federal Contractor Tax Compliance (FCTC) Task Force in 2004.

Last year, the IRS testified about the continued progress we are making with the FCTC task force, and discussed actions we were taking independently of the task force as well as the status of the contractor cases cited by the GAO. Last March, we updated the Subcommittee on our continued progress and addressed the possibility of including Medicare payments made to providers by the Center for Medicare and Medicaid Services (CMS) in the FPLP.

Today, I want to update you on the progress we have made in each of these areas since the Subcommittee's hearing last March as well as to discuss the issue that is the focus of this hearing – the possibility of including Medicaid providers in the continuous levy program.

I also want to thank this Subcommittee for its continued interest in the broad issue of using the FPLP as a means of collecting tax debt. Much of the progress we have made in the past four years has been the direct result of the interest and support of the Subcommittee Members and its staff.

Progress Report

Perhaps the best indicator of the progress made since the creation of the FCTC task force has been the increase in the amount of tax debts that are available to the FMS' Treasury Offset Program (TOP). On January 31, 2004, there was only $73 billion in tax debt referred to FMS. As of October 2007, that number had grown to $127 billion, a 57-percent increase.

Corresponding to this increase in tax debt referred to FMS has been the decline in the number of tax debts that are excluded from the FPLP. In FY 2004, $195 billion had been excluded. By October 2007, that number fell to $160 billion.

As the Subcommittee knows, there are both statutory and operational exclusions to tax debt being referred to the FPLP. While the statutory exclusions have actually increased between FY 2004 and October 2007, from $61 billion to $83 billion, the operational exclusions have declined from $106 billion to $77 billion.

This increase in the overall level of tax debt referred to the FPLP and the decline in the operational exclusions has been the result of a number of actions by the IRS over the last several years. These include:

- Elimination of the one-year waiting period for deferred and queue cases for selection into the FPLP.
- The addition of all field Revenue Officer cases, more Automated Collection System cases, and certain Criminal Investigation cases into the FPLP.
- The addition of the secondary TIN on joint income tax and sole proprietor tax liability accounts.
- The addition of historical business names to improve matching with FMS.
- Adding additional defaulted installment agreements due to programming fixes.
- Adding adjustment claims, pending installment agreements with existing levies, and certain Collection Statute Expiration Date accounts.

In March 2007, the IRS began identifying Federal contractors in its Master file database by using information on recently awarded Federal contracts provided by GSA through FMS. This Federal contractor account indicator will assist the IRS in developing overall collection strategy and prioritization on all corporate inventory accounts.

Total revenue collected through the FPLP has also increased substantially. In FY 2003, there was $89 million in revenue from the FPLP. This had risen to approximately $345 million by FY 2007.

Looking at the subset of contractors, revenue collected from all contractors showed similar growth, rising from $7 million in FY 2003 to $48 million in FY 2007. Defense contractor revenue has gone from $5 million to $25 million over the same period. Since the start of the FPLP in FY 2000, the FPLP has collected over $1.1 billion in Federal payments through FY 2007, of which $195 million was from contractor payments.

Not all of the tax debt referred to the FPLP, however, can be immediately levied due to the notice and review process that is legally required prior to the activation of the levy. Of the $127 billion in tax debt referred to the FPLP inventory, $63 billion, or approximately half, is not currently available for levy. We continue our efforts to accelerate the notice process so that the debts can be levied as soon as legally possible.

We are also making some changes in the IRS case criteria for purposes of the FPLP. These include:

- Levying additional Federal employee salary payments beginning in June 2008.
- Keeping taxpayers who subsequently request an installment agreement (IA) or adjustment claim in the FPLP until a formal IA is established or the adjustment claim remains in a balance due status. This change started in January 2007, and thus far we have been able to keep $454 million in the FPLP.
- Retaining accounts in the FPLP until 30 days prior to the collection statute expiration date (CSED). Prior to this change, these accounts were removed 90 days prior to the CSED.
- Adding a greater number of defaulted installment agreements to the FPLP. This has resulted in 105,000 additional accounts being eligible for the FPLP.

Update on Cases Referred By the GAO

Since 2004, the GAO has referred a number of cases to the IRS that it had identified as having evidence of abusive and/or potentially criminal activity related to the Federal tax system.

Specifically, in 2004 and 2005, GAO referred 47 cases involving defense contractors, 50 cases involving civilian contractors, and 25 cases involving GSA contractors. Since we have received the referrals, the IRS has worked diligently to ensure that all appropriate cases are included in the Federal Payment Levy Program.

Of the total of 122 cases that were referred in 2004 and 2005, 62 cases, or 51 percent, are closed. Of these, 23 cases were full pay closures, and it was determined that the remaining 39 cases were currently not collectible. These non-collectible cases involve defunct corporations or other taxpayers where it is judged that there is no potential now or in the future for collection.

Another 43 of the 122 cases are not currently in an active collection status for the following reasons:

- Six (6) are reported as currently not collectible. This would include hardship cases or cases where we have been unable to contact the taxpayer. Though currently inactive, these cases are subject to periodic review because the circumstances of the taxpayer may change and he/she might be able to pay;
- Nine (9) are in some form of bankruptcy (Chapter 7, 11 or 13);
- Seventeen (17) have an Installment Agreement (IA) or are in Collection Due Process Appeals;
- Three (3) are part of an Offer In Compromise Investigation; and
- Eight (8) have been referred for criminal investigation.

The remaining 17 cases (14 percent) are in active collection status, and investigations to determine collectibility are ongoing. Making the collectibility determination involves working with the taxpayer and using other available resources to verify information obtained from the taxpayer. If the taxpayer is uncooperative, the investigation can be more cumbersome as the taxpayer's assets and liabilities must be researched. The determinations could also involve:

- Permitting the taxpayer a reasonable amount of time to supply financial information;
- Considering a taxpayer's request for an installment agreement by reviewing and requesting verification of the taxpayer's income and expenses as well as assets and liabilities;
- Following up on any notices of levy that have been issued;
- Investigating a lien issue;
- Investigating responsibility and willfulness for the Trust Fund Recovery Penalty;
- Waiting for an appeal period to expire; or
- Conducting a fraud investigation.

To promote compliance, the IRS will continue to take a variety of enforcement actions to ensure that all types of taxpayers are current on their filing and payment requirements. These enforcement actions are often complex and investigation of such issues can be very time-consuming. Several of the audit cases involve complex issues including related entities, bankruptcy, fraud suits, and civil injunctions.

Medicare Cases

During the Subcommittee's hearing on March 20, 2007, the GAO identified an additional 40 cases with evidence that certain Medicare providers may be guilty of abusive or potentially criminal activity relative to Federal income and/or employment taxes. The GAO referred all 40 case studies to the IRS for criminal investigation and collection of any taxes owed.

At that hearing, we explained that we had determined that payments to Medicare providers were indeed Federal payments for purposes of the FPLP and that we were beginning to work with the Center for Medicare and Medicaid Services (CMS) and the FMS to determine how to bring these providers under the continuous levy program.

That work has been overseen by a subgroup of the FCTC task force. CMS joined the FCTC in order to develop a pilot program to incorporate CMS Medicare provider payments (under part A and B) into the FPLP. Currently, CMS Medicare payments are levied through the IRS' regular paper levy collection process.

The FCTC subgroup meets on a regular basis, and after exploring various options, began focusing on developing a pilot program that is tentatively scheduled to go into operation in October 2008. This pilot program would be the same as the process used for levying

Department of Defense payments, known as the Non-Treasury Disbursing Office, or the NTDO process.

Through the pilot program, we would levy Medicare payments disbursed through CMS' centralized Healthcare Integrated General Ledger Accounting System (HIGLAS). This is a systemic process whereby FMS would match information about CMS' payments, on a daily basis, against the tax debts included in the FPLP. FMS would provide information back to CMS when there was a match and CMS would levy the payments.

On October 3, 2007, personnel from FMS and CMS successfully conducted a simulated NTDO pilot program. We are moving ahead with the design and are on track to implement the NTDO process in 2008 for contractors that are currently utilizing the HIGLAS system. We anticipate full implementation during FY 2011.

In addition to exploring the NTDO and TDO systemic processes, we are currently working with CMS to develop a centralized and efficient paper levy process.

We have also done a review of the 40 Medicare cases that the GAO referred. Of the 40 cases, 6 cases (15 percent) are closed because they are either in full pay closure or currently reported as being out of business.

Twenty-three (23) of the 40 cases (58%) are not currently in an active collection status for the following reasons:

- Four (4) are reported as currently not collectible (hardship and unable to contact);
- Six (6) are in bankruptcy (chapter 7, 11 or 13);
- Six (6) have an Installment Agreement;
- Three (3) are Criminal Investigation referrals; and
- Four (4) are under Offer in Compromise investigation.

The remaining 11 cases (27 percent) are in active collection status, and investigations to determine collectibility are on going.

As we pointed out at the March hearing, one of the difficulties of including Medicare providers in the FPLP is that many Medicare physicians operate their practices through limited liability companies (LLCs) which are disregarded for tax purposes under IRS "check-the-box" regulations. In such cases, the individual physicians are personally liable for the tax, but the Medicare payments are legally the property of the LLC, and cannot be directly levied by the IRS. Unless an individual service provider has treated a professional corporation or LLC as an alter ego or mere nominee, the IRS cannot levy on a payment to the entity to collect a tax delinquency of the individual provider.

Under the former "check the box" regulations, if a single-member LLC elected to be treated as a "disregarded entity," the member was liable for all Federal taxes arising from his medical services business (income tax, employment tax, etc.) because the LLC was

disregarded or treated as though it did not exist for tax purposes. The various state laws, however, treated payments to the LLC as the property of and belonging to the LLC – not the individual member. Thus, the IRS generally could not collect the member's Federal tax liabilities by levying or otherwise collecting on payments made to the LLC.

Going forward, the problem of pursuing collection activities for an individual doctor's tax liabilities from payments to single-member "disregarded" LLCs has been addressed, in part, by recently issued Treasury regulations. The IRS and Treasury Department issued final regulations in August 2007 that, once applicable, will "regard" an otherwise disregarded LLC for employment and excise tax purposes. In other words, under the rules in the final regulations, the IRS will be able to collect employment and excise tax liabilities of such an LLC by levying on the income or property of the LLC, because the LLC will be liable for those taxes.

This "entity problem," however, is not limited to disregarded LLCs. Medicare payments for professional medical services could be made to professional corporations through which individual physicians provide services. A levy may not be used to collect the tax liabilities of an individual doctor from Medicare payments for the doctor's services when the Medicare payee is the professional medical corporation that furnished the doctor's services. As with a single-member LLC, under the various state laws such a Medicare payment is the property of the professional corporation rather than of the individual doctor.

Similarly, although the IRS may seize an individual partner's partnership interest to satisfy the partner's tax liability, where the Medicare payments are the property of the partnership, the payments may not be levied upon or seized to satisfy the individual tax liability of the partner.

The challenge presented where the taxpayer is an entity separate from the entity receiving payment is not easily remedied. "Piercing the corporate veil" is a judicial tool available in certain limited circumstances, if the owners or principals of a corporation ignore the legal existence of the separate corporate identity to the detriment of creditors of the business. In those cases, a creditor may ask a court to "pierce the corporate veil" and hold an individual shareholder or principal liable for the debts of the corporation.

In "reverse piercing of the corporate veil," the corporation may be held liable for the debts of an individual shareholder. However, these remedies are available only in egregious situations, typically requiring litigation. In addition, they are expensive to pursue and would not assist in a systemic program such as the FPLP.

Including Medicaid Payments in the FPLP

Last summer, as the GAO was conducting its audit of funds transmitted through the Medicaid program and received by persons delinquent in the payment of Federal taxes, the FCTC task force sought to determine ways in which Medicaid payments might be included in the FPLP. The first step in the process was for the IRS Office of Chief

Counsel to determine whether such payments were like payments to Medicare providers and thus subject to continuous levy. Counsel concluded that the FPLP, as currently structured, is not a tool that can be used for this purpose.

Section 6331(h) of the Internal Revenue Code, the statutory basis for the FPLP, authorizes the IRS to serve a continuous levy on certain specified payments. Specified payments include several statutorily identified disbursements (not including Medicaid payments), as well as a more general category of "Federal payments." Use of the FPLP to levy on Medicaid proceeds depends on whether such disbursements constitute "Federal payments" under section 6331(h)(2)(A).

After careful analysis and consultation with Counsel, the FCTC task force concluded that Medicaid disbursements flowing from the Federal government to state Medicaid agencies do not qualify as Federal payments for purpose of continuous levy under section 6331(h).

In reaching this conclusion, the FCTC weighed various factors relating to the structure and operation of the Medicaid programs. The most pertinent considerations include the actual flow of Medicaid funds, the relationship between the Federal disbursing agency and the recipient state agency, and whether the state or Federal agency faces legal responsibility to providers in the case of non-payment. Each of these considerations suggests that Medicaid disbursements are more in the nature of a state entitlement than a Federal payment includable in the FPLP.

The Medicaid cycle begins with delivery of medical services by a provider. Providers submit claims for reimbursement to the state agency, which, in the vast bulk of cases, pays claims within 30 days. Payment is made with funds representing an aggregate of state and Federal money. Following the payment of claims, the state submits an accounting to CMS of the monies actually paid for a given period. Discrepancies between the advance previously transmitted and the Federal government's obligation to share costs are reconciled in the following quarter's advance.

CMS-provided funds often flow first into a state's general fund before subsequent redirection to the state Medicaid agency or agencies. Once transmitted to the state, there is generally no segregation of the Federal funds based upon actual or intended recipients.

The monies disbursed by CMS under the Medicaid program are monies to which the state Medicaid agency is entitled and over which the state agency exercises control. If a state fulfills the established criteria for participation in the program, CMS cannot withhold Federal funds from the state. The state agency is also granted wide latitude in the use of Federal funds transmitted to it, including discretion to create eligibility standards for enrollment of providers and to establish criteria for disbursement of funds. Furthermore, in the instance of non-payment to a provider, suits may be filed by providers against the state as the legally responsible party. The Federal disbursing agency generally bears no responsibility for non-payment to providers by the state agency.

The Medicaid program is structured so that states, and not Medicaid providers, possess an entitlement to the Federal funds transmitted by CMS. Furthermore, the flow of funds from the Federal government to the state Medicaid agencies, the operational discretion exercised by the state Medicaid agencies, and the state agencies' responsibility for non-payment reflect that state agencies are not mere agents of the Federal government for transmission of funds to medical service providers but, instead, are the actual recipients of such funds. These factors prevent Medicaid payments from qualifying under section 6331(h)(2)(A) of the Internal Revenue Code as "Federal payments," foreclosing the FPLP as currently structured as a means of recovering tax delinquencies of medical service providers.

As we pointed out in our March testimony, the fact that Medicare providers were not yet part of the FPLP did not mean that we were taking no enforcement actions against delinquent providers. The same is true for Medicaid providers. We are utilizing alternative collection means to pursue these delinquent taxpayers.

The GAO has referred the 25 egregious cases it discovered in its audit, and we will take appropriate action on each case. However, I would note that a cursory review of these 25 cases, based on the information provided in the draft GAO report, confirms that the IRS has sought enforcement actions against virtually all of the 25 providers. In some cases, that action involved a lien against the provider or an effort to apply the Trust Fund Recovery Penalty (TFRP). In some cases, the provider was part of the FPLP levy, although not for Medicaid payments.

Summary

Mr. Chairman, working collectively with FMS, GSA, DoD, CMS, and DoJ, and with the support of this Subcommittee, we have made considerable progress in expanding the amount of tax debt that is referred to the FPLP and the total collections that have resulted from those referrals. Taxpayers have every right to expect that anyone receiving Federal payments is current on their tax payments.

We continue to look at ways to expand even further the amount of tax debt that might be referred.

One improvement would be the enactment of a technical correction to the Internal Revenue Code that would allow us to levy up to 100% of all federal vendor payments. This authority was generally granted in 2005 but has not been fully implemented because of a technical deficiency in the statutory language.

Again, I thank the Members of the Subcommittee and your staff for your continued interest in the FPLP program, and I would be happy to respond to any questions that you may have.

STATEMENT OF COMMISSIONER KENNETH R. PAPAJ
U.S. DEPARTMENT OF THE TREASURY
FINANCIAL MANAGEMENT SERVICE
BEFORE THE UNITED STATES SENATE
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Chairman Levin, Ranking Member Coleman, and Subcommittee members, thank you for inviting me here to testify today. I ask that my entire statement be included in the record. I am pleased to have this opportunity to report on the success of the Financial Management Service's (FMS) debt collection program and on our recent accomplishments and ongoing plans to further improve the Federal Payment Levy Program. I'd like to thank the members of this subcommittee and your staffs for your continuing interest in and support of these important efforts.

Record Collections and Steady Growth

FMS operates a highly efficient and effective government-wide debt collection program that collects both tax and nontax debts owed to federal agencies and certain debts owed to states including delinquent child support obligations. I am extremely pleased to report that in fiscal year 2007 the program brought in record-breaking collections of $3.76 billion, $1.7 billion of which was for child support. Of the $3.76 billion, federal tax debt collections totaled approximately $345 million, an increase of $42 million over fiscal year 2006 collections and an increase of over $256 million since fiscal year 2003. Significantly, as shown on the attached chart, collections have shown a steady rise over the last 4 years. Since the inception of the debt collection program at FMS in 1996, we have collected over $31.5 billion in delinquent debt that would otherwise not have been collected.

Of particular interest to this subcommittee, with regard to federal contractors who owe delinquent taxes, I am pleased to report that the number of levies against federal vendor payments increased from 31,054 levies in fiscal year 2006 to 34,388 levies in fiscal year 2007, an increase of 11 percent. Collections from federal contractors totaled $47.4 million in 2007. This number reflects only collections received directly through FMS' Federal Payment Levy Program and does not include additional collections paid to IRS upon the contractor's receipt of the due process notice of the intended levy action.

Recent Accomplishments

Despite these record collections, we realize there is always more to be done and we continuously strive to improve the program. In just the short time since the last subcommittee meeting in March 2007, significant developments have taken place.

First, we have added additional types of payments to the program. In June of this year we added payments issued by the Army Corp of Engineers to both the offset and levy

programs. In October, FMS began offsetting Railroad Retirement Board (RRB) payments with $844 thousand collected in the first two months. We will soon add RRB payments to the levy program when IRS programming changes are complete. Also in August, four months ahead of schedule, we successfully implemented a process to ensure that delinquent taxpayers are not able to bypass the levy process by receiving federal payments via Fedwire, which is a same-day payment mechanism. Delinquent taxpayers are now blocked from receiving Fedwire payments and must receive their payment through a payment mechanism that is subject to levy.

Next, we have put in place reciprocal agreements with the states of Maryland and New Jersey. Under this pilot program, FMS offsets certain federal payments to collect debts owed to participating states and in return, state payments are offset to collect federal debt. Since offsets began in July we have collected $11.8 million of debt owed to Maryland and New Jersey and those states have collected $439,000 of debt owed to the federal government.

Additionally, we continue to work with IRS to increase the number and dollar amount of tax debt that is activated for levy and that work has paid off. The amount of tax debts activated for levy has increased from $53.1 billion in fiscal year 2006 to $62.7 billion in fiscal year 2007. This represents approximately 51% of the tax debt IRS has referred. This is an increase of 2% from last March. To increase this number even further, the administration has proposed a legislative change that would allow IRS to forego the due process that is currently required prior to levy and allow instead for post levy due process under certain circumstances. We believe this would be particularly helpful in ensuring that we don't miss the opportunity to levy payments to federal contractors which are often one-time, non-recurring payments.

Ongoing Efforts

We continue to work to ensure that payments from all the various systems used for making payments to vendors are subject to levy. The latest system to be added, known as the Automated Clearing House – Corporate Trade Exchange or ACH-CTX system, is on target for implementation by the end of December.

We are ready to conduct testing with the United States Postal Service to incorporate into the levy program Postal Service payments to vendors. While programming changes at FMS are complete, this project, initially scheduled to be implemented in June 2007, has been delayed slightly so that the Postal Service can resolve some remaining technical issues. We are on track for full implementation by the end of this year.

FMS continues to pursue legislative initiatives to enhance our debt collection program. We have proposed an initiative that would eliminate the 10-year statute of limitations currently applicable to the collection of nontax debt by administrative offset. In the context of levy, we continue to seek a technical correction to the Internal Revenue Code that would allow IRS to levy up to 100% of all federal vendor payments. This authority was generally granted in 2005 but has not been fully implemented because of a technical deficiency in the statutory language.

At the March hearing, this subcommittee brought to light the important issue of Medicare providers who owe significant amounts of federal tax debt yet continue to receive payments from the federal government. At that time, we committed to working with the IRS and the Center for Medicare and Medicaid Services (CMS) to find a solution. I am very pleased to report that since that time, much progress has been made toward implementing a pilot program to levy Medicare payments through the Federal Payment Levy Program. Staffs from all three agencies participate in a subgroup of the Federal Contractor Tax Compliance Task Force formed to meet this challenge. The subgroup meets on a regular basis and the level of cooperation and support toward achieving this common goal has been extraordinary. FMS staff recently participated in a table-top exercise presented by CMS and its contractor which walked through, in substantial detail, the proposed process for matching CMS payment records with records of delinquent taxpayers and levying those payments when appropriate. We also recently conducted a test match with CMS, matching Medicare Parts A and B payment information from their Healthcare Integrated General Ledger Accounting System (HIGLAS) from just one day with tax debts in the federal payment levy program that have been activated for levy. This resulted in 335 matches with potential collections of $1.1 million.

While the idea of collecting overdue taxes from Medicare providers is relatively straightforward, it is an enormously complex undertaking involving a significant number of systems. Nevertheless, as a result of the commitment and dedication of the three agencies and the support of this subcommittee, the pilot program to levy some Medicare payments is expected to begin in October 2008. In the interim, the task force is working to develop a manual process whereby FMS could provide information to IRS on specific Medicare providers who owe taxes and are about to be paid, so that IRS can issue paper levies. We also continue to work with CMS to explore the option of having FMS disburse Medicare Parts A and B payments so that levies can be conducted using the processes in place for levying other FMS disbursed payments.

We continue to work closely through the Federal Contractor Tax Compliance Task Force on this and other initiatives to improve the Federal Payment Levy Program. More detail regarding the accomplishments of the task force will be included in a written report to be issued to the subcommittee early next year.

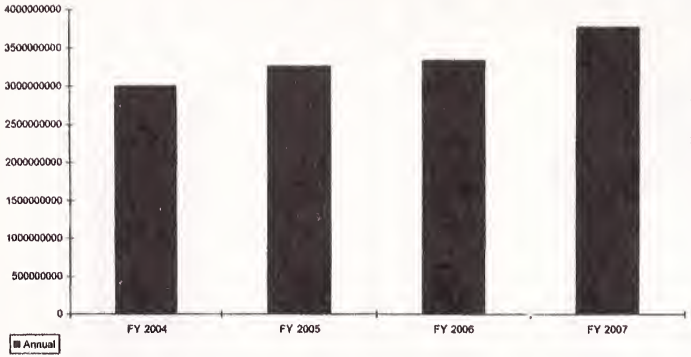
Levying Medicaid Payments

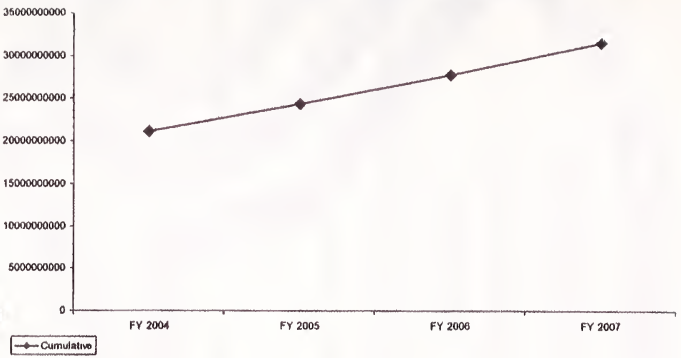
You have specifically asked me to address issues surrounding the levy of Medicaid payments in response to recent findings by the Government Accountability Office on Medicaid providers who owe delinquent taxes. Unlike Medicare payments which are disbursed by the federal government, Medicaid payments to providers are issued by the states. This introduces legal and operational complexities that are not present under Medicare. The Federal Contractor Tax Compliance Task Force has examined the issue of incorporating Medicaid payments into the Federal Payment Levy Program. IRS has determined that such payments are not federal payments subject to continuous levy under current law. Nevertheless, along with IRS and CMS, we will continue to examine this

issue to determine how best to overcome existing legal hurdles and ensure that any process to levy payments to Medicaid providers is operationally feasible and not unduly burdensome and costly to the federal government or to states. We expect that this will be a complex and long-term effort. However, in the interim, because of the significant overlap between Medicare and Medicaid providers, we are optimistic that progress can be made toward reducing the tax obligations of Medicaid providers through our continuing efforts to implement a process to levy Medicare payments.

This concludes my statement. I would be happy to respond to any questions.

FMS Collections



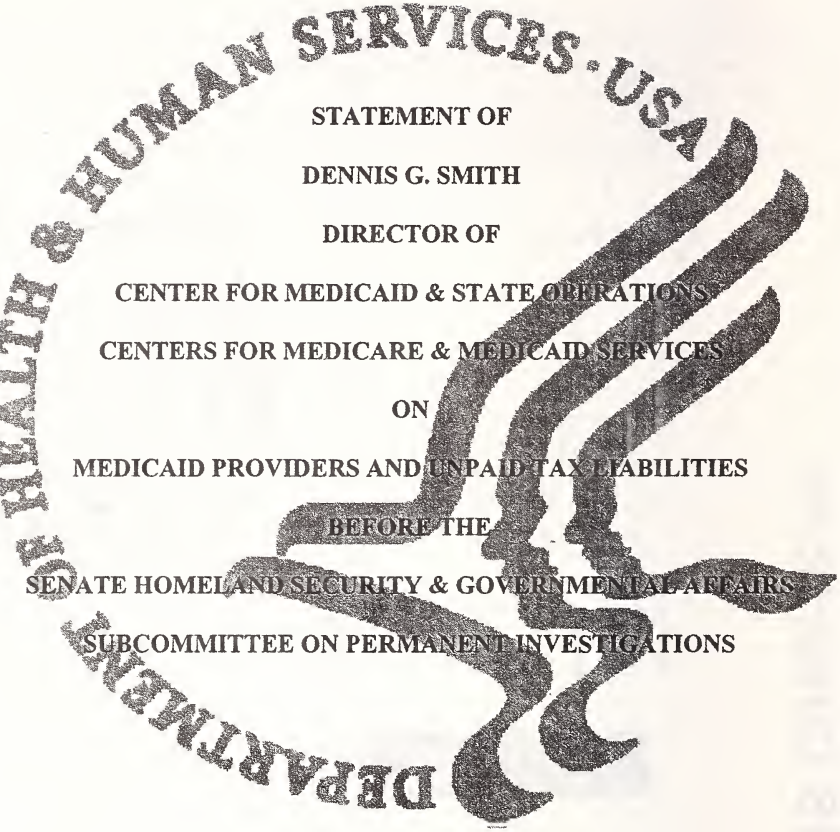


Annual

2004	$3,005,174,029
2005	$3,252,877,421
2006	$3,336,476,916
2007	$3,758,212,151

Cumulative

2004	$21,163,293,032
2005	$24,416,170,453
2006	$27,752,647,369
2007	$31,510,859,519



STATEMENT OF

DENNIS G. SMITH

DIRECTOR OF

CENTER FOR MEDICAID & STATE OPERATIONS

CENTERS FOR MEDICARE & MEDICAID SERVICES

ON

MEDICAID PROVIDERS AND UNPAID TAX LIABILITIES

BEFORE THE

SENATE HOMELAND SECURITY & GOVERNMENTAL AFFAIRS

SUBCOMMITTEE ON PERMANENT INVESTIGATIONS

November 14, 2007

CMS
CENTERS for MEDICARE & MEDICAID SERVICES

Testimony of Dennis G. Smith
Director of the Center for Medicaid and State Operations at the
Centers for Medicare & Medicaid Services
on
Medicaid Providers and Unpaid Tax Liabilities
Before the
Senate Homeland Security & Governmental Affairs
Permanent Subcommittee on Investigations
November 14, 2007

Chairman Levin, Senator Coleman, and distinguished members of the Subcommittee, thank you for inviting me to participate in the discussion about potentially adding Medicaid to the Federal Payment Levy Program (FPLP). In Fiscal Year (FY) 2008, Medicaid will pay an estimated $345.6 billion to hundreds of thousands of health care providers and plans including hospitals, nursing homes, physicians, and even taxi cabs to provide health care services to 50 million Americans. Medicaid is designed and administered by the States and many Medicaid providers are small businesses who contract directly with the States to provide services to beneficiaries. We do not, at the Federal level, either enroll or pay providers directly. As a result, States have a considerable stake in this discussion and would be instrumental partners in any potential solution.

In light of that fact, my objective today is to explain how Federal payments are made to States for health care services covered by the Medicaid program for Medicaid-eligible individuals. I hope this information will be helpful in any deliberations on how to proceed in concert with the Internal Revenue Service (IRS), the U.S. Treasury's Financial Management Service (FMS) and critically, the States.

Medicaid: A Partnership with States

Medicaid is a means-tested health care program for low-income Americans, administered by the States within a Federally defined framework. The Centers for Medicare & Medicaid Services (CMS) provides matching payments to States and Territories to cover Medicaid services and related administrative costs. State medical assistance payments are matched according to a formula relating each State's per capita income to the national average. The Federal government's share of a State's Medicaid expenditures for medical assistance is called the Federal Medical Assistance Percentage (FMAP), which currently ranges between 50 and 76.29 percent.

Each State and Territorial Medicaid program is unique. States set eligibility, coverage, and payment standards within broad statutory and regulatory guidelines. State governments have a great deal of programmatic flexibility within which to tailor their Medicaid programs to the unique political, budgetary, and economic environments in each State. Accordingly, there is variation among the States in terms of eligibility, covered services, and provider reimbursements. States administer the Medicaid program, set rules and reimbursement rates for providers and health plans, and make payments to the providers and plans. Critical to the issue under discussion today, CMS does not pay Medicaid providers or health plans; CMS financing of Medicaid is limited to making payments to States to match State expenditures for medical assistance.

As noted earlier in my testimony, the Federal share of a Medicaid payment varies from State to State. For example, the Federal share of a Medicaid payment to a provider in New York, based on a 50 percent FMAP, would be less than the Federal share of a payment to a provider in Mississippi, which has a FMAP of 76.29 percent. These divergent FMAPs are compounded by the different rates of reimbursement for covered services, which are individually set by States. More to the point for today's discussion, these Federal share differentials could result in two providers in two different states with the same Federal tax liability being subject to different amounts withheld.

Medicaid Financing and Payments

The CMS is responsible for making quarterly payments of Federal matching funds to States and Territories for their allowable expenditures for services rendered and administration. On a quarterly basis, a State estimates its Medicaid expenditures prospectively by electronically submitting Form CMS-37 through the State's Medicaid/SCHIP Budget & Expenditure System (MBES) for the next quarter. Completion of this form is necessary for CMS to issue the initial quarterly Medicaid grant award money to the State. Upon review of Form CMS-37, CMS determines the amount of the grant award to be made available to the State. CMS may conclude that MBES expenditures be increased, decreased, or accepted. If a State's grant award is insufficient, the State may also submit a revised Form CMS-37 to request additional funding at a later time.

Based on this review, the initial quarterly grant award is then prepared and forwarded to CMS's Office of Financial Management (OFM) for processing. Upon receipt of the award notices, OFM records the amount into the Apportionment Control System to verify there are sufficient Medicaid funds available to issue to State agencies. A grant award letter is mailed to the State, and funds from the U.S. Treasury are made available to State agencies to draw down electronically.

At the end of each quarter, a State then submits the Quarterly Medicaid Statement of Expenditures (Form CMS-64), which provides the actual quarterly State Medicaid expenditures information. Form CMS-64 is also filed electronically through the MBES to CMS. On this form, States report both the current expenditures and any such adjustments from previous time periods. CMS then reconciles Medicaid grant funds that were provided in advance to States with actual State Medicaid expenditures. If the reconciliation process finds that a payment is required of CMS to the State, a supplemental grant award letter is issued through the same process as outlined for the estimated quarterly expenditures. CMS may also find that claims filed by the State do not adhere to Federal statute, or do not constitute appropriate services covered under Medicaid. Consequently, payments can be disallowed or deferred. A notification letter is

sent out to the State regarding any such actions. A State may appeal an adverse determination to the Health and Human Services (HHS) Departmental Appeals Board and eventually through the Federal courts.

For purposes of today's discussion, it is critical to keep in mind that actual payments to Medicaid providers happen at the State level. CMS does not cut checks directly to providers. In many cases, third-party vendors holding contracts with the States issue the provider reimbursement payments. States typically pay their vendors every two weeks through their MMIS. Payments are automated. The vendors that run these systems are typically paid whenever an edit is made to change the amount of payment and on a transaction basis. It is difficult to assess the most cost-effective means for participating in the levy program across all the States. Solutions and approaches may vary depending on the number of providers involved in the FPLP in a particular State.

Medicaid Claims Processing

To further illustrate this payment system and the overall complexity of State Medicaid payments, I'd like to explain how States typically reimburse providers participating in a State's Medicaid program. When a health care provider sees a Medicaid patient, she first verifies that the person is eligible for Medicaid coverage, typically using an on-line real time electronic confirmation with the State. A series of procedures are undertaken and identified by code number on an electronic bill, using standard, Health Insurance Portability and Accountability Act (HIPAA)-compliant formats, with each code pegged to a specific charge by the provider.

This bill is then sent electronically to the State's claims processing system, generally known as the Medicaid Management Information Systems (MMIS). The claim is bounced against several internal files within the MMIS to verify from the State's perspective that:

- The bill is from a Medicaid-certified provider of care (the provider file);
- The bill is filed on behalf of a person eligible on that day for Medicaid benefits (eligibility file);

- There is no other insurer or other payer who should pay all or a portion of the costs (because Medicaid is the "Payer of Last Resort");
- The services provided are within the scope of the State's benefit package and appropriate for the diagnosis; and
- The services provided are against a fee schedule that the State has agreed to pay for the particular procedure. Most State Medicaid reimbursement rates are considerably less than what the provider would charge other insurers.

There may be additional edits to the individual claim as well, depending upon the State. Assuming all edits are passed, the Medicaid agency typically sends the bill on to the appropriate financial State agency for payment, which generally occurs in a State Department of Finance or State Department of Treasury. After these steps, the Medicaid provider receives a check from the State Agency or an electronic payment deposited into the provider's bank account.

Naturally, these specific payment steps vary among small and large providers participating in the Medicaid program. If the provider is a member of a larger health care group practice, the practice rather than the individual provider would generally submit the bill to the State and receive the payment, after which the individual provider may receive payment in whole or in part, depending upon the practice's financial arrangement. Similarly, with regard to managed care organizations (MCOs), the MCO may bill the State on behalf of multiple payers on a fee-for service basis, or choose to lump all services via monthly capitation rate times the number of participating providers within the MCO regardless of specific services rendered.

Current Limitations

Current law does not readily allow for the expansion of the FPLP to the Medicaid program, nor do State and Federal budgets anticipate the costs that would be incurred as a result of this potential change. Neither CMS nor the State Medicaid agencies have the authority to examine the tax records of providers. Moreover, many States contract with private businesses to process claims. CMS does not enroll providers or reimburse them

directly for their services; this is an administrative activity that varies by State and is entirely a State function. Therefore, States would be likely to view the FPLP as an unfunded mandate, outside the scope of their responsibilities to pay for medical services.

This endeavor would be significantly more complex for Medicaid than what CMS has been working towards on Medicare; there are different vendors, different systems, and different platforms among the 56 independent Medicaid jurisdictions. The challenges that would be associated with such an approach involve the number and complexities of the payment system in each State, the difficulties and costs associated with making changes to them for this tax levy purpose, the need to establish electronic pathways between FMS and each system which do not currently exist, and the potential delays in payments to Medicaid providers due to constant auditing and adjusting of their claims history. Since payment to each Medicaid provider is a mix of Federal and State dollars, which varies from State to State ranging from 50 to 76.29 percent for the Federal portion, these different FMAP rates would need to be included in any algorithm that would be necessary for this purpose. While all States use their respective MMIS for making payments, there are additional systems that may also be paying claims to certain providers or subsets of providers which would also need to be modified.

It is difficult to determine a precise cost estimate for these changes. The Federal government would have the expenditure of working with each State individually to build the infrastructure necessary to link State and Federal systems, and States may themselves face constraints in terms of how quickly they could complete work on their end. In addition, apart from the software and consulting services needed to maintain the flow of day-to-day operations for all of the other providers who not affected by this new program, the State would incur some level of additional cost for staffing oversight, response to complaints, etc.

Finally, it is important to point out that many States may not want to competitively bid this new work, but would instead prefer to have their incumbent contractor do the work on a "sole source/no-bid" basis. To do anything else would run the risk of another

contractor making changes incompatible with the normal flow of the claims payment processing engine already in place in each State.

Conclusion

CMS is already collaborating with the IRS and Treasury's FMS in the Federal Contractor Tax Compliance (FCTC) Task Force to determine how best to address Medicare providers delinquent in the realm of tax obligations. CMS supports the work of the Task Force to examine, assess and ultimately implement policies to ensure that payments to providers are levied in the most effective and appropriate manner. As we further discuss unpaid tax liabilities in the Medicaid program, CMS will build on our existing role in the Task Force and provide technical assistance regarding the legal and practical challenges of expanding the FPLP to Medicaid.

United States Government Accountability Office

GAO

Report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

November 2007

MEDICAID

Thousands of Medicaid Providers Abuse the Federal Tax System

This Report Is Temporarily Restricted Pending Official Public Release.

GAO-08-17

Permanent Subcommittee on Investigations
EXHIBIT #1

November 2007

GAO
Accountability· Integrity· Reliability
Highlights

Highlights of GAO-08-17, a report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

MEDICAID

Thousands of Medicaid Providers Abuse the Federal Tax System

Why GAO Did This Study

In fiscal year 2006, outlays for Medicaid were about $324 billion; about $185 billion was paid by the federal government. Because GAO previously identified abusive and criminal activity associated with government contractors owing billions of dollars in federal taxes, the subcommittee requested GAO expand our work to Medicaid providers.

GAO was asked to (1) determine if Medicaid providers have unpaid federal taxes, and if so, the magnitude of such debts; (2) identify examples of Medicaid providers that have engaged in abusive or criminal activities; and (3) determine whether the Centers for Medicare & Medicaid Services (CMS) and the states prevent health care providers with tax problems from enrolling in Medicaid or participating in the continuous levy program to pay federal tax debts.

To perform this work, GAO analyzed tax data from the Internal Revenue Service (IRS) and Medicaid data from seven selected states based on magnitude of Medicaid payments and geography. GAO also performed additional investigative activities.

What GAO Recommends

GAO is recommending that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program and evaluate 25 cases for additional collection action and criminal investigation. IRS agreed with our recommendations.

To view the full product, including the scope and methodology, click on GAO-08-17. For more information, contact Greg Kutz at (202) 512-6722 or kutzg@gao.gov.

What GAO Found

Over 30,000 Medicaid providers, about 5 percent of those paid in fiscal year 2006, had over $1 billion of unpaid federal taxes. These 30,000 providers were identified from a nonrepresentative selection of providers from seven states: California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas. This $1 billion estimate is likely understated because some Medicaid providers have understated their income or not filed their tax returns.

We selected 25 Medicaid providers with high federal tax debt as case studies for more in-depth investigation of the extent and nature of abuse and criminal activity. For all 25 cases we found abusive and related criminal activity, including failure to remit individual income taxes or payroll taxes to IRS. Rather than fulfill their role as "trustees" of federal payroll tax funds and forward them to IRS, these providers diverted the money for other purposes. Willful failure to remit payroll taxes is a felony under U.S. law. Individuals associated with some of these providers diverted the payroll tax money for their own benefit or to help fund their businesses. Many of these individuals accumulated substantial assets, including million-dollar houses and luxury vehicles, while failing to pay their federal taxes. In addition, some case studies involved businesses that were sanctioned for substandard care of their patients. Despite their abusive and criminal activity, these 25 providers received Medicaid payments ranging from about $100,000 to about $39 million in fiscal year 2006.

Examples of Medicaid Providers with Abusive and Criminal Activity

Type of business	Unpaid tax debt	Fiscal year 2006 Medicaid payments	Description of activity
Nursing home	$2 million	$6 million	Owner fined for jeopardizing health and safety of patients.
Counselor	$200,000	$200,000	Owner indicted for fraud for several hundred thousands of dollars relating to a federal program.
Ambulance service	$300,000	$300,000	All business's assets were seized by a law enforcements agency for money laundering.

Source: GAO analysis of IRS, CMS, public, and other records.

CMS and our selected states do not prevent health care providers who have federal tax debts from enrolling in Medicaid. CMS officials stated that such a requirement for screening potential providers for unpaid taxes could adversely impact states' ability to provide health care to low income people. Further, federal law generally prohibits the disclosure of taxpayer data to CMS and states.

No tax debt owed by Medicaid providers has ever been collected through the continuous levy program. During our audit, IRS had not made a determination on whether Medicaid payments are considered "federal payments" and thus eligible for its continuous levy program. For fiscal year 2006, if an effective levy was in place for the seven selected states, GAO estimates that the federal government could have collected between $70 million and $160 million.

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Abbreviations

CMS	Centers for Medicare & Medicaid Services
EIN	employer identification number
FCTC	Federal Contractors Tax Compliance
FMS	Financial Management Service
HHS	Department of Health and Human Services
IRS	Internal Revenue Service
SSN	Social Security number
TFRP	trust fund recovery penalty
TIN	taxpayer identification number
TOP	Treasury Offset Program

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GAO
Accountability * Integrity * Reliability
United States Government Accountability Office
Washington, DC 20548

November 14, 2007

The Honorable Carl Levin
Chairman
The Honorable Norm Coleman
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

The success of our tax system hinges on the public's perception of its fairness, including the extent to which taxpayers believe their friends, neighbors, and businesses are complying with the tax laws and are actually paying their taxes. The Internal Revenue Service's (IRS) own data in this regard are not encouraging. IRS reported that the federal government does not receive hundreds of billions of dollars in taxes owed annually. IRS's most recent estimate is that the gross tax gap (the difference between the taxes that should have been paid voluntarily and on time and what was actually paid) was $345 billion for tax year 2001. IRS estimated that it would eventually collect $55 billion of this amount, leaving a net tax gap of $290 billion in unpaid taxes. IRS enforcement of the tax laws is vital to promote compliance by giving taxpayers confidence that others are paying their fair share. Because of the challenges that IRS faces in its enforcement of tax laws, we continue to include it as a high-risk area for IRS.[1]

A portion of the tax gap is owed by individuals and businesses receiving payments from the federal government. For example, over the past several years, we testified that federal contractors (Department of Defense, federal civilian, and General Services Administration contractors) abused the federal tax system with little consequence.[2] Due to the significance of the issues raised during those hearings, you asked us to provide additional

[1]GAO, *High-Risk Series: An Update*, GAO-07-310 (Washington, D.C.: Jan. 2007).

[2]GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-414T (Washington, D.C.: Feb. 12, 2004); *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, GAO-05-683T (Washington, D.C.: June 16, 2005); and *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, GAO-06-492T (Washington, D.C.: Mar. 14, 2006).

information about whether Medicare and Medicaid providers were engaged in similar tax abuses.[3]

This is the second in a series of reports and testimonies to respond to your request. In March 2007, we testified that Medicare physicians, health professionals, and suppliers paid under the Supplemental Medical Insurance program, also known as Medicare Part B, had abused the federal tax system while doing business with the federal government.[4] This report will cover Medicaid health care providers from seven selected states who also abused the federal tax system.

The specific objectives of this forensic audit and related investigation were, to the extent possible, (1) determine if providers who receive Medicaid payments have unpaid federal taxes, and if so, the magnitude of federal tax debts owed by these Medicaid providers; (2) identify examples of providers engaged in abusive and criminal activity related to the federal tax system; and (3) determine whether Centers for Medicare & Medicaid Services (CMS) and selected states prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay federal tax debts.

To identify the extent to which Medicaid providers had unpaid federal taxes, we obtained and analyzed fiscal year 2006 Medicaid payments made to providers in a nonrepresentative selection of seven states:[5] California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas.[6] Payments to these states constituted about 43 percent of all Medicaid payments made during fiscal year 2006. These states were selected based on the magnitude of Medicaid payments and geographical location. We also obtained and analyzed the IRS tax debt data as of September 30, 2006.

[3]In addition to our audits of federal contractors with tax debts, we also conducted audits of combined federal campaign charities and exempt organizations with federal tax debts. GAO, *Tax Debt: Some Combined Federal Campaign Charities Owe Payroll and Other Federal Taxes*, GAO-06-887 (Washington, D.C.: July 28, 2006) and *Tax Compliance: Thousands of Organizations Exempt from Federal Income Tax Owe Nearly $1 Billion in Payroll and Other Taxes*, GAO-07-563 (Washington, D.C.: June 29, 2007).

[4]GAO, *Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System*, GAO-07-587T (Washington D.C.: Mar. 20, 2007).

[5]There are 56 Medicaid programs, including one for each of the 50 states, the District of Columbia, Puerto Rico, American Samoa, Guam, Northern Mariana Islands, and the Virgin Islands. Hereafter, all 56 entities are referred to as states.

[6]Throughout this report, these seven states are referred to as the selected states.

We matched the lists of Medicaid providers with IRS tax debts using the taxpayer identification number (TIN) to identify Medicaid providers with tax debts. To illustrate the extent and nature of tax system abuse or potentially criminal activity, we selected 25 Medicaid providers for a detailed audit and investigation. The 25 providers were chosen based on the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by Medicaid, and indications that owner(s) might be involved in multiple companies with tax debts. For these 25 Medicaid providers, we reviewed copies of automated tax transcripts and other tax records (for example, revenue officer's notes) and performed additional searches of criminal, financial, health care, and public records.

To determine whether CMS and states prevent health care providers with unpaid federal taxes from enrolling in Medicaid, we interviewed officials from CMS and selected states and examined the CMS and selected states' regulations, policies, and procedures for making determinations in the enrollment approval process. We also interviewed officials from CMS, IRS, and the Department of the Treasury's Financial Management Service (FMS) concerning any barriers for levying Medicaid payments. A more detailed description of the scope and methodology related to our audit and investigative work supporting this report is provided in appendix I.

We conducted our audit work from July 2006 through August 2007 in accordance with U.S. generally accepted government auditing standards. We performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Results in Brief

In seven selected states, thousands of Medicaid providers abused[7] the federal tax system with little or no consequence. Specifically, our analysis of data provided by the selected states and IRS indicates that over 30,000 Medicaid providers from the selected states, over 5 percent, had tax debts totaling over $1 billion as of September 30, 2006.[8] The unpaid taxes largely

[7]We considered activity to be abusive when a Medicaid provider's actions or inactions, though not illegal, took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

[8]Because some Medicaid providers may do business with Medicare and other federal agencies, such as Veterans Affairs, some of the approximately 30,000 Medicaid providers described in this report may also have been included in our reports concerning the Department of Defense, General Services Administration, civilian federal contractors, Medicare Part B providers, and tax-exempt organizations that abuse the federal tax system.

consisted of individual income and payroll taxes.[9] The $1 billion estimate of tax debts owed by Medicaid providers is likely understated because IRS data do not reflect all amounts owed by businesses and individuals. Specifically, these do not include amounts owed by businesses and individuals that have not filed tax returns or that have failed to report the full amount of taxes due (referred to as nonfilers and underreporters) and for which IRS has not determined which specific tax debts are owed.

Our audit and investigative work details the nature of abusive and criminal activity related to the federal tax system by 25 Medicaid providers. These 25 providers were paid by Medicaid for a variety of services, including hospital, nursing facility, physician, and ambulance services. Payments ranged from about $100,000 to approximately $39 million during fiscal year 2006. Many were established businesses that owed federal payroll taxes withheld for their employees. Rather than fulfill their role as "trustees" of these funds and forward them to IRS as required by law, these health care providers diverted the money for other purposes. These payroll taxes included amounts withheld from employee wages for Social Security, Medicare, and individual income taxes.[10]

At the same time that they were not paying their federal taxes, many individuals associated with our 25 cases bought or owned significant personal assets, including commercial properties, expensive homes, and luxury vehicles. One business officer withdrew over $100,000 in cash at casinos at the same time the business owed millions of dollars in federal taxes. Further, another case study business was sanctioned by its state regulator for substandard care of its patients.

CMS and the selected states do not prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid. CMS has not developed regulations to require states to (1) screen health care providers for unpaid taxes and (2) obtain consent for IRS disclosure of federal tax debts. CMS officials stated that the primary focus of the Medicaid program, in partnership with the states, is to provide health care

[9]Payroll taxes include amounts that employers withhold from employees' wages for federal income taxes, Social Security, and Medicare as well as the related employer matching contributions for Social Security and Medicare taxes. Employers are responsible for remitting payroll taxes to IRS and are liable for any outstanding balance.

[10]Willful failure to remit payroll taxes is a criminal felony offense while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense. 26 U.S.C. §§ 7202, 7215 and 7512 (b).

services for low income people and not the administration of taxes. CMS officials stated that such a requirement could be a burden to the states in their enrollment of providers and could adversely impact states' ability to provide health care to the poor. Even if CMS did want to screen health care providers with tax debts, federal law generally prohibits the disclosure of taxpayer data to CMS and states.[11] Thus, CMS and states do not have access to tax data directly from IRS unless the taxpayer provides consent. Consequently, CMS and the selected states have no mechanism or requirement to prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid.

A provision of the Taxpayer Relief Act of 1997 authorizes IRS to continuously levy certain federal payments made to delinquent taxpayers. However, in the 10 years since its passage, IRS had not determined whether Medicaid payments are considered federal payments, and thus subject to the continuous levy program, or determined the feasibility of incorporating these payments into the program. Thus, no tax debt owed by Medicaid providers has ever been collected from medicaid payments through the continuous levy program. If there had been an effective levy program in place, we estimate that for fiscal year 2006, the selected seven states could have levied payments for the federal government and collected between $70 million to about $160 million of unpaid federal taxes. Officials from all seven of the selected states stated that they have a continuous levy program to offset Medicaid payments against their state debts.

Our report makes two recommendations to the IRS Commissioner. First, we recommend that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program. In responding to a draft of our report, IRS agreed with our recommendation but stated that it has already completed studies on whether the Medicaid payments can be incorporated into the continuous levy program. From those studies, IRS concluded that Medicaid disbursements do not qualify as federal payments and therefore cannot be incorporated in the continuous levy program. We modified our report accordingly. IRS agreed with our second recommendation—to evaluate the 25 referred cases detailed in this report for appropriate additional aggressive collection

[11]States screen health care providers prior to enrollment into the Medicaid program. States also process and pay Medicaid claims and are reimbursed for the federal share of these payments by CMS.

action and criminal investigation as warranted. While we did not make recommendations to either CMS or FMS, they provided technical and other comments to the report. See the "Agency Comments and Our Evaluation" section of this report for a more detailed discussion of agency comments from IRS, CMS, and FMS. We have reprinted the IRS and CMS written comments in appendixes III and IV.

Background

Title XIX of the Social Security Act is a federal and state entitlement program that pays for medical assistance for certain categories of low-income adults and children. This program, known as Medicaid, became law in 1965 and is jointly funded by the federal and state governments (including the District of Columbia and the Territories). Medicaid is the largest source of funding for medical and health-related services for America's poorest people. More than 50 million persons enrolled in the Medicaid program in fiscal year 2006. In fiscal year 2006, according to CMS, total outlays for Medicaid (federal and state) were approximately $324 billion, of which about $185 billion was paid by the federal government.

Medicaid is jointly funded by the federal and state governments. The federal government shares in a state's Medicaid service costs through a matching formula. The federal matching rate for the cost of services provided to Medicaid beneficiaries is related to a state's per capita income and in federal fiscal year 2006 ranged from 50 percent to 76 percent.

Centers for Medicare & Medicaid Services

Although the federal government establishes general guidelines for the Medicaid program, requirements are established by each state. CMS, within the Department of Health and Human Services (HHS), is responsible for administering federal matching funds to the states and for legislation and regulations affecting the Medicaid program. CMS also provides guidelines, technical assistance, and periodic assessments of state Medicaid programs.

State Medicaid Agencies

Title XIX of the Social Security Act allows considerable flexibility within the states' Medicaid plans. Within broad national guidelines established by federal statutes, regulations, and policies, each state (1) establishes its own eligibility standards; (2) determines the type, amount, duration, and scope of services; (3) sets the rate of payment for services; and (4) administers its own program—including enrollment of providers. Medicaid policies for eligibility, services, and payment are complex and

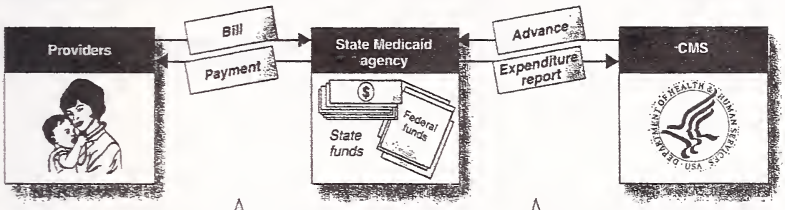
vary considerably, even among states of similar size or geographic proximity. Thus, a person who is eligible for Medicaid in one state may not be eligible in another state, and the services provided by one state may differ considerably in amount, duration, or scope from services provided in a similar or neighboring state. In addition, state legislatures may change Medicaid eligibility, services, or reimbursement during the year.

To receive payment for services or goods provided to beneficiaries from Medicaid, providers must first enroll in the Medicaid program. To enroll, providers must submit a Medicaid enrollment application to the state or their fiscal agents who are responsible for determining whether the providers meet federal and state requirements for enrollment. The state or its fiscal agents are responsible for screening the applications based on CMS and state policies. Once an applicant is deemed eligible by the state or its fiscal agents, Medicaid providers can submit their claims to the state for payment. The state is responsible for claims processing and verifying the claim is accurate, complete, medically necessary, and covered under the state's Medicaid plan. After the claim is approved, the state pays the claim.

The typical Medicaid payment process is illustrated in figure 1. When a Medicaid beneficiary receives care from a health care provider such as a hospital, physician, or nursing home, the provider bills the state Medicaid program for its services. The state in turn pays the provider from a combination of state funds and federal funds, which have been advanced by CMS each quarter. The state then files an expenditure report, in which it claims the federal share of the Medicaid expenditure as reimbursement for its payment to providers and reconciles its total expenditures with the federal advance.[12] In addition to reimbursement for medical services, the state may claim federal reimbursement for functions it performs to administer its Medicaid program, such as enrolling new beneficiaries; reviewing the appropriateness of providers' claims; and collecting payments from third parties, which are payers other than Medicaid, such as Medicare, that may be liable for some or all of a particular health claim.

[12]Each quarter, states submit to CMS an estimate of their Medicaid expenditures for the upcoming quarter. CMS then authorizes the states to draw on federal funds to pay the federal Medicaid share.

Figure 1: Typical Medicaid Payment Process



Transaction 1: A Medicaid beneficiary receives care from a health care provider, such as a physician; the provider bills the state Medicaid program; and the state pays the provider by drawing on a pool of state funds combined with a quarterly advance on federal matching funds.

Transaction 2: The state files an expenditure report, in which it claims the federal Medicaid matching share as reimbursement for its payments to providers and reconciles total quarterly expenditures with the federal advance. States may file claims for medical services and for administrative functions.

Source: GAO, Art Explosion (clip art)

Magnitude of Unpaid Federal Taxes of Medicaid Providers

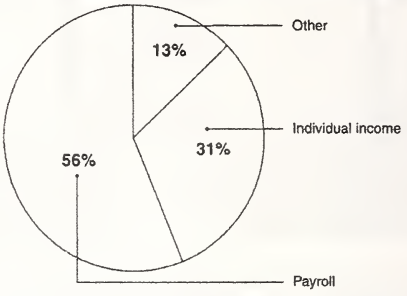
Our analysis found that over 30,000 Medicaid providers at the selected states had over $1 billion in unpaid federal taxes as of September 30, 2006.[13] This represents over 5 percent of the approximately 560,000 Medicaid providers paid by the selected states during federal fiscal year 2006. The amount of unpaid federal taxes we identified among Medicaid providers is likely understated because (1) we intentionally limited our scope to providers with agreed-to federal tax debt for tax periods prior to 2006, and (2) the IRS taxpayer data reflect only the amount of unpaid taxes either reported by the taxpayer on a tax return or assessed by IRS through its various enforcement programs and thus the unpaid tax debt amount does not include entities for which IRS had not identified that they did not file tax returns or underreported their income.

[13]Our estimate of Medicaid providers with tax debt as of September 30, 2006, excluded (1) tax debts that have not been agreed to by the tax debtor or affirmed by the court, (2) tax debts from calendar year 2006, (3) approved Medicaid claims less than $100, and (4) tax debts less than $100.

Characteristics of Medicaid Providers' Unpaid Federal Taxes

As shown in figure 2, 87 percent of the approximately $1 billion in unpaid taxes was comprised of individual income and payroll taxes. The other 13 percent of taxes included corporate income, excise, unemployment, and other types of taxes.

Figure 2: Medicaid Providers' Unpaid Taxes by Tax Type



Source: GAO analysis of Medicaid and IRS data as of September 30, 2006

As shown in figure 2, over half of the unpaid taxes owed by Medicaid providers were payroll taxes. Employers are subject to civil and criminal penalties if they do not remit payroll taxes to the federal government. When an employer withholds taxes from an employee's wages, the employer is deemed to have a responsibility to hold these amounts "in trust" for the federal government until the employer makes a federal tax deposit in that amount. To the extent these withheld amounts are not forwarded to the federal government, the employer is liable for these amounts, as well as the employer's matching Federal Insurance Contribution Act contributions for Social Security and Medicare. Individuals within the business (e.g., corporate officers) may be held personally liable for the withheld amounts not forwarded and they maybe assessed a civil monetary penalty known as a trust fund recovery penalty (TFRP).[14] Willful failure to remit payroll taxes can also be a criminal felony offense punishable by imprisonment up to 5 years, [15] while the failure to

[14]26 U.S.C. § 6672.

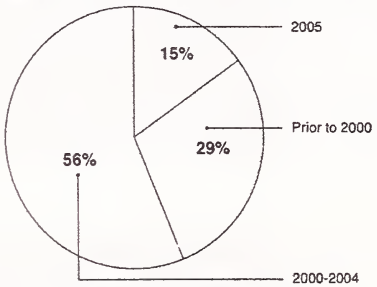
[15]26 U.S.C. § 7202.

properly segregate payroll taxes can be a criminal misdemeanor offense punishable by imprisonment of up to 1 year.[16]

The law imposes no penalties upon an employee for the employer's failure to remit payroll taxes since the employer is responsible for submitting the amounts withheld. The Social Security and Medicare trust funds are subsidized or made whole for unpaid payroll taxes by the general fund. Thus, personal income taxes, corporate income taxes, and other government revenues are used to pay for these shortfalls to the Social Security and Medicare trust funds.

A substantial amount of the unpaid federal taxes shown in IRS records as owed by Medicaid providers had been outstanding for several years. As reflected in figure 3, about 56 percent of the $1 billion in unpaid taxes was for tax periods from calendar year 2000 through calendar year 2004, and approximately 29 percent of the unpaid taxes was for tax periods prior to calendar year 2000. [17]

Figure 3: Unpaid Taxes of Medicaid Providers by Calendar Year



Source: GAO analysis of Medicaid and IRS data as of September 30, 2006.

[16]26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

[17]A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is generally one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.

Our previous work has shown that as unpaid taxes age, the likelihood of collecting all or a portion of the amount owed decreases.[18] This is due, in part, to the continued accrual of interest and penalties on the outstanding tax debt, which, over time, can dwarf the original tax obligation. The amount of unpaid federal taxes reported above does not include all tax debts owed by Medicaid providers due to statutory provisions that give IRS a finite period under which it can seek to collect on unpaid taxes. There is a 10-year statute of limitations beyond which IRS is prohibited from attempting to collect tax debt.[19] Consequently, if the Medicaid providers owe federal taxes beyond the 10-year statutory collection period, the older tax debt may have been removed from IRS's records. We were unable to determine the amount of tax debt that had been removed.

Unpaid Federal Taxes of Medicaid Providers Is Understated

Although over $1 billion in unpaid federal taxes owed by Medicaid providers as of September 30, 2006, is a significant amount, it likely understates the full extent of unpaid taxes owed by these or other businesses and individuals. The IRS tax database reflects only the amount of unpaid federal taxes either reported by the individual or business on a tax return or assessed by IRS through its various enforcement programs. The IRS database does not reflect amounts owed by businesses and individuals that have not filed tax returns and for which IRS has not assessed tax amounts due. For example, during our audit, we identified instances from our case studies in which Medicaid providers failed to file tax returns for a particular tax period and IRS had not assessed taxes for these tax periods.[20] Consequently, while these providers had unpaid federal taxes, they were listed in IRS records as having no unpaid taxes for that period.

[18]GAO, *Internal Revenue Service: Recommendations to Improve Financial and Operational Management*, GAO-01-42 (Washington D.C.: Nov. 17, 2000).

[19]The 10-year time limit may be suspended and include periods during which the taxpayer is involved in a collection due process appeal, litigation, a pending offer-in-compromise, or an installment agreement. As a result, fig. 3 includes taxes that are for tax periods from more than 10 years ago.

[20]For example, one of the Medicaid provider case studies had not filed personal income tax returns for the last couple of years. According to IRS records, the Medicaid provider in question earned at least $300,000 in revenue in the last tax year of our review. In another case example, a Medicaid provider had not filed its tax returns for the last several years. In fact, the IRS revenue officers indicated that the provider was defunct. However, according to IRS records, the Medicaid provider in question earned at least $1 million in revenue in the last tax year of our review and after the provider was classified as defunct.

Further, our analysis did not attempt to account for businesses or individuals that purposely underreported income and were not specifically identified by IRS as owing the additional federal taxes. According to IRS, underreporting of income accounted for more than 80 percent of the estimated $345 billion annual gross tax gap.[21]

Finally, our analysis did not attempt to identify Medicaid providers who owed taxes under a separate TIN from the TIN that received the Medicaid payments. For example, sole proprietors and certain limited liability companies may file Medicaid claims under their Social Security numbers (SSN). If these Medicaid providers had employees, they would typically report the payroll taxes under an employer identification number (EIN) and not their SSNs. Consequently, the full extent of unpaid federal taxes for Medicaid providers is not known.

In addition to the IRS tax database not reflecting all assessed tax amounts due, our past audits[22] have also found that the IRS tax database contains coding errors that adversely affect IRS's collection activities. IRS's collection process is heavily dependent upon its automated computer system and the information that resides within this system. In particular, the codes in each taxpayer's account in IRS's tax database are critical to IRS in tracking the collection actions it has taken against a tax debtor and in determining what, if any, additional collection actions should be pursued. For example, IRS uses these codes to identify cases it should exclude from the continuous levy program,[23] which is an automated method of collecting tax debt by offsetting certain federal payments made to individuals and businesses, as well as cases it should exclude from other collection actions.

[21]According to IRS, nonfilers and underpayment of taxes made up the rest of the gross tax gap.

[22]GAO, *Internal Revenue Service: Procedural Changes Could Enhance Tax Collections*, GAO-07-26 (Washington D.C.: Nov. 15, 2006).

[23]Each week IRS sends FMS an extract of its tax debt files containing updated account balances of tax debts that are already in Treasury Offset Program (TOP), the new tax debts that need to be added to TOP, and all taxes in TOP that need to be removed. FMS sends payment data to TOP to be matched against these unpaid federal taxes. If there is a match and IRS has updated TOP to reflect that it has completed all legal notifications, the federal payment is reduced (levied) to help satisfy the unpaid federal taxes. In addition to federal tax debts, the TOP database also includes federal nontax debts, state tax debts, and child support debts.

Examples of Extent and Nature of Medicaid Providers' Abusive and Potentially Criminal Activity Related to the Federal Tax System

For all 25 cases that we audited and investigated, we confirmed that their activities were abusive and in many instances found criminal activity related to the federal tax system. Of these cases, 17 involved businesses with employees who had unpaid payroll taxes, most dating as far back as the late 1990s. However, rather than fulfill their role as "trustees" of this money and forward it to IRS, these Medicaid providers diverted the money for other purposes, including their own salaries. As stated earlier, willful failure to remit payroll taxes can be a criminal felony offense punishable by imprisonment up to 5 years,[24] while the failure to properly segregate payroll taxes can be a criminal misdemeanor offense punishable by imprisonment of up to 1 year.[25]

Table 1 highlights 10 cases of businesses and individuals with unpaid taxes. Our investigations revealed that, despite their businesses owing substantial amounts of taxes to IRS, some owners had substantial personal assets—including expensive homes and luxury cars. We are referring the 25 cases detailed in our report to IRS for appropriate collection action and criminal investigation.

Table 1: Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
1	Hospital	$9 million	$5 million	• Business's tax debts are primarily composed of unpaid payroll taxes beginning in the late 1990s. • IRS reported tax debts to the continuous levy program for collection action. • IRS proposed an injunction to close the business in a recent year because the business continued to accumulate tax debt. • IRS assessed a TFRP against business owners. • IRS attempted to levy a bank account but the owner closed the account prior to the levy. • Business owners had several large cash transactions in recent years. • Owners own two residences worth over $2 million. • IRS and the state filed tax liens against the business. • Business received over $2 million dollars in Medicare payments in a recent year.

[24]26 U.S.C. § 7202.

[25]26 U.S.C. § 7215 and 26 U.S.C. § 7512 (b).

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
2	Nursing home	$6 million	$2 million	• Business's federal tax debts are primarily composed of unpaid payroll taxes. • Business received nearly $2 million in Medicare payments in a recent year. • IRS reported tax debts to the continuous levy program for collection action. • Business charged with patient abuse, and business and business owner also fined and suspended for jeopardizing the health and safety of patients. • IRS filed tax liens against the business and business owner. • Related business owes over $1 million of unpaid taxes that have been referred to the continuous levy program.
3	Nursing facility	$3 million	$3 million	• Business's federal tax debts are primarily unpaid payroll taxes. • Business officer owns multiple properties; one worth over $1 million. • IRS assessed over a $1 million TFRP against the business officer. • Business defaulted on an installment agreement with IRS. • Business received nearly $3 million in Medicare payments in a recent year. • IRS reported business's tax debts to the continuous levy program. • Business is involved in a lawsuit for malpractice in a recent year. • Business officers filed for bankruptcy in early 2000s. • IRS filed tax liens against the business. • Business officer owns a related business that owes over $200,000 in unpaid federal taxes. IRS reported the related business' tax debts to the continuous levy program.
4	Pharmacy	$100,000	$800,000	• Business's tax debts are primarily unpaid payroll taxes covering over 7 years. For most of these tax periods, the business filed late and made no tax payments. • Business filed for bankruptcy in the mid-2000s. • Business officer sold assets of the business even though the officer knew the business owed unpaid taxes and also knew that liens were filed. • IRS assessed a nearly $3 million TFRP against the business officer. • IRS and state filed tax liens against the business. • Business officer owns a related business that owes unpaid federal taxes.
5	Home health services	$2 million	$1 million	• Business's tax debts are primarily unpaid payroll taxes. • Business filed for bankruptcy while a business officer continued to earn over $250,000 a year. • Business officer owns a luxury vehicle and property worth about $1 million located near a golf course. • Business received over $1 million in Medicare payments in a recent year. • IRS assessed a TFRP against a business officer. • IRS and state filed tax liens against the business.

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
6	Dental	$200,000	$300,000	• Dentist's tax debts are primarily unpaid income taxes. • Dentist generally had not made any federal tax payments since early 1990s. • In a recent year, dentist earned over $300,000 and did not file an income tax return. • Dentist owes debts to other federal agencies, including delinquent student loan debt. • IRS and state filed tax liens against the dentist.
7	Home care	$2 million	$3 million	• Business's tax debts are primarily unpaid payroll taxes beginning in the late 1990s. • Business did not file tax returns in late 1990s and early 2000s. • Business owners own multiple real properties, including a million dollar residence, luxury vehicles, and a recreational boat. • IRS assessed over $1 million TFRP against one business owner. • Business filed bankruptcy in a recent year. • IRS and state filed tax liens against the business. • Business owners own several related health care businesses which are in bankruptcy status.
8	Clinic	$3 million	$1 million	• Business's tax debts are primarily unpaid payroll taxes. • Business owner borrowed over $2 million from the business while business owed payroll taxes. • Business owner owns residential property worth nearly $4 million dollars, several luxury vehicles, and a recreational boat. • Business did not file required tax return in a recent year. • IRS assessed a TFRP against owner. • IRS and state filed tax liens against the business.
9	Nursing home facilities	$39 million	$16 million	• Business's tax debt is primarily unpaid payroll taxes. • Business fined for quality of care violations in early 2000s. • Business officer withdrew over $100,000 in cash at casinos at the same time he was not paying the nursing home's taxes. • Multimillion-dollar IRS and state tax liens filed against the business.
10	Professional counselor	$200,000	$200,000	• Owner's tax debt is primarily individual income taxes. • Owner and spouse currently under investigation for mail fraud. • Owner has a felony conviction. • Owner indicted for fraud for several hundred thousand dollars relating to a federal program. • IRS filed tax liens against the owners.

Source: GAO analysis of IRS, FMS, Medicaid claims, public, and other records.

Notes: Dollar amounts are rounded. The nature of unpaid taxes for businesses was primarily due to unpaid payroll taxes. A Medicaid provider can submit claims using either an EIN or SSN. In our report, any provider submitting a claim with an EIN is referred to as a business, and any provider submitting a claim with an SSN is referred to as an individual.

[a]Medicaid payments are Medicaid claims paid by states for fiscal year 2006 (October 1, 2005, to September 30, 2006).

[b]Unpaid tax amount was as of September 30, 2006.

The following provides illustrative detailed information on four cases we audited and investigated.

- Case 1: During the time the owners of the hospital owed over $5 million in payroll taxes, the owners purchased a vacation home worth about $1 million. IRS assessed a trust fund recovery penalty (TFRP) of nearly $2 million against the owners, filed federal tax liens totaling nearly $8 million against the owners and hospital, attempted to levy the owners' bank accounts, and proposed an injunction to close the hospital because the business continued to accumulate tax debt. The hospital received over $9 million in Medicaid payments during fiscal year 2006.

- Case 2: While owing over $2 million in unpaid payroll taxes, the nursing home owner and business were fined for jeopardizing the health and safety of their patients. The nursing home owner attempted to sell the business and other real estate property and promised to pay tax debts in full. However, the owner did not sell the business or real estate and took other actions to avoid federal tax liens. IRS fined the owner over $400,000 in a recent year for intentionally disregarding IRS's tax reporting and filing requirements. The owner also has a related business that owes over $1 million in unpaid taxes. The nursing home received over $6 million in Medicaid payments during fiscal year 2006.

- Case 4: The managing officer of a pharmacy sold off business assets without notifying IRS while knowing that the business owed over $800,000 in unpaid payroll taxes over 7 years. In an attempt to collect unpaid debts from the officer, IRS assessed a TFRP of nearly $3 million and filed federal tax liens against the officer and the business. The officer owns a related entity that also owes a large amount of taxes, and recently started up a new corporation using the same address as the pharmacy. The pharmacy received nearly $100,000 in Medicaid payments during fiscal year 2006.

- Case 8: A medical clinic owner owns a house worth nearly $4 million, several luxury vehicles, and a pleasure boat while owing taxes. The owner also borrowed over $2 million from the business and sold properties for about $1 million at the same time the business owed over $1 million in unpaid payroll taxes. In addition, IRS generated a tax return for the business in a recent year because the business owner did not file it. The medical clinic received over $2 million in Medicaid payments during fiscal year 2006.

In addition to the 25 cases that we identified through IRS tax records, we separately also found a Medicaid provider that was recently convicted for

failure to pay employment taxes owed by several nursing homes.[26] The nursing home businesses received over $25 million in Medicaid payments during fiscal year 2006. According to court documents, the nursing homes owed over $14 million in unpaid taxes. At the same time the businesses owed taxes, the owner bought a 10,000 square foot house with a current estimated value of over $2 million. The court records indicate that the owner spent tens of thousands of dollars furnishing the house including crystal chandeliers, a 132-piece set of Haviland Bavarian porcelain china, and oriental rugs. The owner used company funds to pay personal expenses such as a housekeeper, children's nanny, monthly pension for a parent who never worked at the company, a sailboat, and jet-skis. While owing taxes, the owner also went on vacations to Hawaii and gambling trips to Las Vegas and Reno, Nevada. Court records also indicate that while in Hawaii, the owner bought a $16,000 Rolex watch, the day before one of the required federal tax deposits was due.

Providers with Unpaid Federal Taxes Are Not Prohibited from Enrolling or Receiving Payments from Medicaid

CMS and the selected states do not prevent health care providers who have tax debts from enrolling in or receiving payments from Medicaid. CMS has not developed regulations to require states to (1) screen health care providers for unpaid taxes and (2) obtain consent for IRS disclosure of federal tax debts. CMS officials stated that the primary focus of the Medicaid program is to provide health care services for low income people and not the administration of taxes. Further, federal law generally prohibits the disclosure of taxpayer data to CMS and states and thus, CMS and states do not have access to tax data directly from IRS unless the taxpayer provides consent.[27] Further, none of the seven states we contacted have ever implemented a continuous federal tax levy for Medicaid payments. Thus, Medicaid payments to providers that owe federal taxes are not being continuously levied.

Screening for Unpaid Taxes

Federal law does not prohibit providers with unpaid federal taxes from enrolling in and billing Medicaid. Federal regulations and policies require the states, as part of their responsibilities for determining whether the

[26]Taxpayer records (e.g., IRS Unpaid Assessment File, transcripts) were not accessed for this case example. All information concerning this case was found through court records and Medicaid claim information provided by the state.

[27]States screen health care providers prior to enrollment into the Medicaid program. States also process and pay the Medicaid claims and are reimbursed for the federal share of such payments by CMS.

providers meet Medicaid requirements for enrollment, to verify basic information on potential providers, including whether the providers meet state licensure requirements and whether the providers are prohibited from participating in federal health care programs. However, federal regulations and policies do not require the states to screen these providers for federal tax delinquency nor do they explicitly authorize the states to reject the providers that have delinquent tax debt from participation in Medicaid. CMS officials stated that the primary focus of the Medicaid program is to provide health care services for low income people and not the administration of taxes. CMS officials stated that such a requirement could be a burden to the states in their enrollment of providers and could adversely impact states' ability to provide health care to the poor. Consequently, the selected states' processes generally do not consider federal tax debts of prospective providers in the Medicaid enrollment process.[28]

Further, due to a statutory restriction on disclosure of taxpayer information, even if tax debts specifically were to be considered in enrollment in Medicaid, no coordinated or independent mechanism exists for the states to obtain complete information on providers that have unpaid tax debt. Federal law does not permit IRS to disclose taxpayer information, including tax debts, to CMS or Medicaid state officials unless the taxpayer consents, which neither CMS nor the states currently seek.[29] Thus, certain tax debt information can only be discovered from public records if IRS files a federal tax lien against the property of a tax debtor or if a record of conviction for tax offense is publicly available.[30] Consequently, CMS and state officials do not have ready access to information on unpaid tax debts to consider in making decisions on Medicaid providers.

[28]Officials from California stated that they do consider federal debts, including tax debts, if it is self-disclosed on the Medicaid application. California officials said that no verification is made.

[29]26 U.S.C. § 6103.

[30]Under section 6321 of the Internal Revenue Code, IRS has the authority to file a lien upon all property and rights to property, whether real or personal, of a delinquent taxpayer.

Medicaid Payments to Providers Are Not Subject to IRS Continuous Levy

Although a provision of the Taxpayer Relief Act of 1997 authorizes IRS to continuously levy certain federal payments made to delinquent taxpayers, no tax debt owed by Medicaid providers has ever been collected using this provision of the law.[31] In the 10 years since its passage, IRS had not determined whether Medicaid payments are federal payments and thus subject to the continuous levy program or determined the feasibility of incorporating these payments into the program.[32]

If there had been an effective levy program in place, we estimate that the selected states could have levied payments for the federal government and collected between $70 million to about $160 million of unpaid federal taxes during fiscal year 2006.[33] This estimate was based on those debts that IRS reported to the Treasury Offset Program (TOP) as of September 30, 2006. Officials from all these selected states stated that they have a continuous levy program to offset Medicaid payments against their state debts.

Conclusions

Available data indicate that the vast majority of Medicaid providers appear to pay their federal taxes. However, our work has shown that over 30,000 Medicaid providers have taken advantage of the opportunity to avoid paying their federal taxes. While Medicaid providers are relied on to deliver significant medical services to those most in need, they must also pay their fair share of federal taxes. Many of the individuals involved in our cases have consistently not paid their taxes yet have received millions of dollars in Medicaid payments and have faced no criminal consequences.

[31]To improve the collection of unpaid taxes, IRS is authorized to continuously levy up to 100 percent for federal payments related to goods and services. To implement this levy authority, IRS, in coordination with the Department of the Treasury's FMS, implemented the Federal Levy Payment Program in July 2000. This program uses FMS's Treasury Offset Program (TOP) for the levy of federal payments.

[32]In addition to the continuous levy program, IRS also has the authority to legally seize property either held by the taxpayer or owned by the taxpayer and held by a third party. This authority includes the seizure of Medicaid receivables held by states and owed to health care providers. Unlike levies from the continuous levy program, each levy is typically a one-time seizure of property (i.e., Medicaid receivables) held by states at a specific point of time and is done on a case-by-case basis based on the particular circumstances of the case. IRS officials stated that they do not know how much in tax levies were collected from Medicaid payments.

[33]Medicaid providers from the seven selected states had $475 million in tax debts in TOP as of September 30, 2006. In addition, these providers had $241 million in federal nontax debts, $202 million in delinquent child support, and $6 million in state tax debts.

At the same time, some of these individuals are living lives of luxury, financed in part by Medicare and Medicaid payments. Also, IRS has taken little action to explore the continuous levy of Medicaid payments, which over time potentially could have resulted in millions of dollars of collections or to aggressively pursue collection and criminal investigation of the individuals involved in our 25 case studies.

Recommendations for Executive Action

We recommend that the Commissioner of the Internal Revenue Service take the following two actions:

- Conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program.
- Evaluate the 25 referred cases detailed in this report for appropriate additional aggressive collection action and criminal investigation as warranted.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from the Acting Commissioner of Internal Revenue (see app. III) and Acting Administrator of CMS (see app. IV). We also received an e-mail response from FMS.

IRS concurred with our recommendations. In response to our recommendation that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program, IRS stated that both a subgroup of the Federal Contractors Tax Compliance (FCTC) task force and IRS General Counsel have completed an independent study on whether the Medicaid payments can be incorporated into the continuous levy program. Both the FCTC task force and IRS General Counsel concluded that Medicaid disbursements do not qualify as federal payments and therefore cannot be incorporated in the continuous levy program.

In response to a draft of our report, CMS expressed concern about the tone and language we used to discuss our findings. Specifically, CMS interpreted our finding that over 30,000 Medicaid providers had over $1 billion of unpaid federal taxes as implying that "there is some direct correlation between owing taxes and being a Medicaid provider." Our report clearly states that the vast majority of Medicaid providers are paying their taxes. For the 5 percent of Medicaid providers with tax debt, we simply reported on the facts of what we found, which do not require additional evaluation to satisfactorily address our objective. Furthermore,

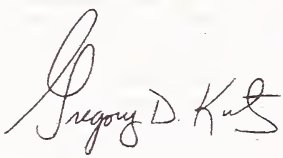
regarding our third objective, CMS interpreted our report as implying that there is an underlying connection between the activity (preventing providers with tax problems from participating in the Medicaid program) and the authority and responsibility to perform such activity. Again, it appears that CMS misinterpreted our findings. We specifically stated that federal law does not prohibit providers with unpaid taxes from enrolling in and billing Medicaid. Although CMS is not required to screen potential providers for tax debts, we are concerned that CMS stated it would be inappropriate to prevent medical providers that owe federal taxes participating in the Medicaid program—which would presumably include those egregious cases we identified in this report. We believe that any CMS action to prevent medical providers who refuse to pay their taxes from participating in the Medicaid program would help ensure the integrity of the Medicaid program and does not necessarily conflict with CMS's role in providing health care to low-income individuals.

Both CMS and FMS expressed concern with their agencies involvement in the continuous levy program. CMS stated that we implied that CMS and the Medicaid agencies should be conducting the continuous levy on these payments. FMS stated that our report indicated that, because Medicaid payments include funds the states receive from the federal government, the Medicaid payment is a federal payment. Our report did not state that CMS and the Medicaid agencies should be conducting the continuous levy on Medicaid payments nor did we state that Medicaid payments are federal payments. However, we did report that IRS had not determined whether Medicaid payments are federal payments and recommended that IRS conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program.

CMS and FMS also provided us technical corrections to the report which we incorporated, as appropriate.

As agreed with your office, unless you publicly release its contents earlier we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Secretary of the Treasury, the Commissioner of the Financial Management Service (FMS), the Acting Commissioner of Internal Revenue, the Acting Administrator of Centers for Medicare & Medicaid Services (CMS) and interested congressional committees.

The report is also available at no charge on the GAO Web site at http://www.gao.gov. If you have any questions concerning this report, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.



Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Appendix I: Scope and Methodology

To identify the magnitude of unpaid federal taxes owed by Medicaid providers, we used a nonrepresentative selection of states. We selected the states of California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas based on the magnitude of payments made to Medicaid providers and the geographical location of those states. We obtained and analyzed Internal Revenue Service (IRS) tax debt data as of September 30, 2006. We also obtained and analyzed the selected states' federal fiscal year 2006 approved Medicaid payments to providers. We matched the Medicaid payment data to the IRS unpaid assessment data using the taxpayer identification number (TIN) field. To avoid overestimating the amount owed by Medicaid providers with unpaid tax debts and to capture only significant tax debts, we excluded from our analysis tax debts and paid claims meeting specific criteria to establish a minimum threshold for the amount of tax debt and for the amount of paid claims to be considered when determining whether a tax debt was significant. The criteria we used to exclude tax debts are as follows:

- tax debts that IRS classified as compliance assessments or memo accounts for financial reporting,[1]
- tax debts from calendar year 2006 tax periods, and
- Medicaid providers with total unpaid taxes and Medicaid paid claims of less than $100.

These criteria were used to exclude tax debts that might be under dispute or generally duplicative or invalid, and tax debts that were recently incurred. Specifically, compliance assessments or memo accounts were excluded because these taxes have neither been agreed to by the taxpayers nor affirmed by the court, or these taxes could be invalid or duplicative of other taxes already reported. We excluded tax debts from calendar year 2006 tax periods to eliminate tax debt that may involve matters that are routinely resolved between the taxpayer and IRS, with the taxes paid or abated within a short period. We further excluded tax debts and Medicaid-paid claims of less than $100 because they are insignificant for the purpose of determining the extent of taxes owed by Medicaid providers. Our analysis also did not attempt to identify Medicaid providers

[1]Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivables. Compliance assessments and memo accounts are not considered federal taxes receivable because they are not agreed to by taxpayers or the courts.

who owed taxes under a separate TIN from the TIN under which the Medicaid payments were received. As a result, the full extent of unpaid federal taxes for Medicaid providers is understated.

To identify indications of abuse or potentially criminal activity, we selected 25 Medicaid providers for a detailed audit and investigation. The 25 providers were chosen using a nonrepresentative selection approach based on our judgment, data mining, and a number of other criteria. Specifically, we narrowed down providers to 25 with unpaid taxes based on the amount of unpaid taxes, number of unpaid tax periods, amount of payments reported by Medicaid, and indications that owner(s) might be involved in multiple companies with tax debts. For these 25 cases, we obtained copies of automated tax transcripts and other tax records (for example, revenue officer's notes) from IRS and performed additional searches of criminal, financial, and public records. In cases where record searches and IRS tax transcripts indicated that the owners or officers of a business were involved in other related entities[2] that have unpaid federal taxes, we also reviewed the related entities and the owner(s) or officer(s), in addition to the original business we identified. In instances where we identified related parties that had both Medicaid payments and tax debts, our case studies included those related entities, combining unpaid taxes and combined Medicaid payments for the original individual/business as well as all related entities. Because our investigations were generally limited to publicly available information, our audit of the 25 cases may not have identified all related parties or all significant assets (i.e., personal bank data, companies established to hide assets) that the Medicaid providers own.

To determine the extent to which Centers for Medicare & Medicaid Services (CMS) officials and the states are required to consider tax debts or other criminal activities in the enrollment of providers into Medicaid, we examined CMS policies and procedures, Medicaid regulations, and the selected policies for enrollment. We also discussed policies and procedures used to enroll providers into Medicaid with officials from the selected states. As part of these discussions, we inquired whether the selected states specifically consider tax debts or perform background investigations to determine whether a prospective provider is qualified

[2]We define "related entities" as entities that share common owner(s) or officer(s), a common TIN, or a common address.

before the enrollment to Medicaid is granted. To determine the extent to which Medicaid payments to providers are continuously levied to pay tax debts, we examined the statutory and regulatory authorities that govern the continuous levy program and interviewed officials from CMS, IRS, and Department of the Treasury's Financial Management Service (FMS) to determine whether any legal barriers existed.

To determine the potential levy collections on Medicaid payments during fiscal year 2006, we used 15 percent and 100 percent of the total paid claim or total tax debt amount reported to the Treasury Offset Program (TOP), whichever was less. A gap will exist between what could be collected and the maximum levy amount calculated because (1) tax debts in TOP may not be eligible for immediate levy because IRS has not completed due process notifications and (2) tax debts may become ineligible for levy because of a change in collection status (e.g., tax debtor filed for bankruptcy).

We conducted our audit work from July 2006 through August 2007 in accordance with U.S. generally accepted government auditing standards, and we performed our investigative work in accordance with standards prescribed by the President's Council on Integrity and Efficiency.

Data Reliability Assessment

To determine the reliability of the IRS unpaid assessments data, we relied on the work we performed during our annual audits of IRS's financial statements. While our financial statement audits have identified some data reliability problems associated with the coding of some of the fields in IRS's tax records, including errors and delays in recording taxpayer information and payments, we determined that the data were sufficiently reliable to address this report's objectives. Our financial audit procedures, including the reconciliation of the value of unpaid taxes recorded in IRS's masterfile to IRS's general ledger, identified no material differences.

For the selected states' Medicaid payment databases and FMS's TOP databases, we interviewed the selected states' and FMS officials responsible for their respective databases. In addition, we performed electronic testing of specific data elements in the databases that we used to perform our work. On the basis of our discussions with agency officials, review of agency documents, and our own testing, we concluded that the data elements used for this testimony were sufficiently reliable for our purposes.

Appendix II: Medicaid Providers with Unpaid Federal Taxes

This appendix presents summary information on the abusive or potentially criminal activity associated with 15 of our 25 case studies. Table 2 shows the remaining case studies that we audited and investigated. As with the 10 cases discussed in the body of this report, we also found substantial abuse and potentially criminal activity related to the federal tax system during our review of these 15 Medicaid providers that also received Medicaid payments in federal fiscal year 2006. The case studies involving businesses primarily involved unpaid payroll taxes.

Table 2: Additional Medicaid Providers with Unpaid Federal Taxes

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
11	Physician	$100,000	$300,000	• Physician's tax debt is primarily individual income taxes. • Physician owns several luxury cars. • Physician defaulted on an installment agreement with IRS. • Physician did not file income tax returns in recent years. • Physician received tens of thousands of dollars from Medicare in a recent year. • IRS filed tax liens against the physician.
12	Hospital	$13 million	$7 million	• Hospital's tax debts are primarily composed of unpaid payroll taxes dating back to the late 1990s. • IRS reported tax debts to continuous levy program. • Hospital received tens of millions of dollars in Medicare payments in a recent year. • IRS assessed trust fund recovery penalty (TFRP) against the business officer. • Business officer admitted hiding money from creditors in a recent year. • IRS and state filed tax liens against the hospital.
13	Medical center	$1 million	$1 million	• Business's tax debts are primarily composed of unpaid payroll taxes. • Business officer owns over $1 million property and a luxury vehicle. • IRS reported related business tax debts to the continuous levy program. • IRS and state filed tax liens against the business. • Business received over $300,000 in Medicare payments in a recent year.
14	Physician	$100,000	$300,000	• Physician's tax debts are primarily unpaid individual income taxes. • Physician has made little, and in some instances no, federal tax payments to IRS since the late 1990s. • Physician claimed limited ability to pay taxes. However, physician owns a residential property worth over $1 million and also received tens of thousands of dollars from Medicare in a recent year. • Physician owes debts to another federal agency. • IRS and state filed tax liens against the physician.

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
15	Physician	$200,000	$200,000	• Physician's tax debts are primarily unpaid individual income taxes dating back to early 2000s. • Physician is being sued for malpractice. • IRS filed tax liens against the physician. • IRS reported tax debts to continuous levy program.
16	Business services	$600,000	$500,000	• Business tax debts are primarily unpaid payroll taxes. • IRS rejected the business owner's offer to pay about 10 percent to settle the tax debt due to the owner's ability to pay more. • Business owner has an egregious history of not paying taxes. • Business owner filed late returns and did not make any payroll tax payment for over 5 years. • IRS assessed a TFRP against the business owner. • Business owner was recently assessed a TFRP for another related business.
17	Ambulance services	$700,000	$400,000	• Owner's tax debts are primarily unpaid individual income taxes for every year for a decade. • Business owner has made no effort to pay taxes owed. • Owner made several large cash transactions in recent years. • Business owner has multiple real estate properties, including several investment properties.
18	Dental	$200,000	$400,000	• Dentist's tax debts are primarily unpaid individual income taxes dating back to the late 1990s. • Dentist did not file tax returns in the early 2000s. • Dentist owes delinquent student loans. • IRS and state filed tax liens against the business.
19	Medical equipment and supplies	$300,000	$500,000	• Business tax debts are primarily unpaid payroll taxes dating back to the late 1990s. • Business officer owns a luxury vehicle. • IRS reported tax debts to continuous levy program. • IRS and state filed tax liens against the business.
20	Transportation services	$900,000	$2 million	• Business officers own multiple real estate properties, including a residential property worth about $1 million and two multimillion-dollar commercial properties. • Received over $3 million in Medicare payments in a recent year. • IRS assessed a TFRP against the owner. • IRS and state filed tax liens against the business.
21	Dental	$200,000	$200,000	• Dentist's tax debts are primarily unpaid individual income taxes dating back to the mid-1990s. • Dentist convicted of tax evasion.

Case	Nature of work	Medicaid payments[a]	Unpaid federal tax[b]	Comments
22	Family services	$500,000	$3 million	• Business tax debts are primarily unpaid payroll taxes. • IRS assessed TFRP against business officers. • Business earned over $3 million in a recent year. • IRS and state filed tax liens against the business.
23	Nursing services	$1 million	$2 million	• Business tax debts are primarily unpaid payroll taxes. • Business earned over $1 million in a recent year. • IRS reported business as being in defunct status. • IRS reported tax debts to continuous levy program. • IRS filed tax liens against the business.
24	Ambulance services	$300,000	$300,000	• Business tax debts are primarily payroll taxes. • All business's assets were seized by law enforcement agency for money laundering. • Business in defunct status in a recent year. • Business received over $2 million in Medicare payments in the year prior to being defunct. • Owner arrested for cocaine possession. • IRS and state filed tax liens against the business. • IRS assessed a TFRP against the owner.
25	Home health services	$4 million	$900,000	• Business debts are primarily unpaid payroll taxes. • Business officer owns a luxury vehicle. • IRS assessed a TFRP against the business officers. • IRS and state filed tax liens against the business.

Source: GAO analysis of IRS, FMS, Medicaid claims, public, and other records.

Notes: Dollar amounts are rounded. The nature of unpaid taxes for businesses was primarily due to unpaid payroll taxes. A Medicaid provider can submit claims using either an Employer Identification Number (EIN) or Social Security Number (SSN). In our report, any provider submitting a claim with an EIN is referred to as a business, and any provider submitting a claim with an SSN is referred to as an individual.

[a]Medicaid payments are Medicaid claims paid by states for fiscal year 2006 (October 1, 2005, to September 30, 2006).

[b]Unpaid tax amount was as of September 30, 2006.

Appendix III: Comments from the Internal Revenue Service

COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D C 20224

September 21, 2007

Mr. Gregory Kutz
Managing Director, Forensic Audits and
Special Investigations
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Kutz:

I have reviewed the draft Government Accountability Office (GAO) report titled: "Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System" (GAO-08-17) and agree with the recommendations. Your report acknowledges the complexity of Medicaid's policies for eligibility, services and payments.

The IRS recognizes the importance and benefits of using the Federal Payment Levy Program (FPLP) as a mechanism to collect delinquent taxes by levying numerous other categories of federal payments disbursed or administered through Financial Management Services (FMS). During Fiscal Year (FY) 2006 alone, we collected $299 million through FPLP as compared to $197 million in FY 2005. Through July 2007, we collected $286 million.

We are currently working with FMS and the Centers for Medicare and Medicaid Services (CMS) as part of a subgroup of the Federal Contractors Tax Compliance (FCTC) task force. We are exploring two options to systemically levy all CMS Medicare payments. The first option is to utilize the process for levying Department of Defense payments, known as the Non Treasury Disbursed Office process. The second option proposes to have FMS take on the disbursement process of the CMS contractors in the Healthcare Integrated General Ledger Accounting System, known as the Treasury Disbursed Office process.

The FCTC subgroup has also considered the feasibility of incorporating into the FPLP disbursements made to medical providers under the Medicaid program. The FCTC subgroup analysis concluded that Medicaid disbursements flowing from the federal government to state Medicaid agencies do not qualify as federal payments for the purpose of continuous levy under section 6331(h) of the Internal Revenue Code. The FCTC subgroup's analysis is based on the nature of the Medicaid disbursement as a state entitlement, and the considerable operational discretion vested in state agencies in the administration of the Medicaid program, including discretion to create unique eligibility standards for enrollment of providers and to establish criteria for disbursement

of funds. These important factors distinguish Medicaid disbursements from federal payments under Medicare, which are transmitted more directly from the federal government to medical providers. IRS' Office of Chief Counsel also completed a study of these issues and concurred with the FCTC subgroup's conclusion that Medicaid disbursements do not qualify as federal payments subject to continuous levy.

If you have any questions, or if you would like to discuss this response in more detail, please contact Frederick W. Schindler, Director, Collection Policy at (202) 283-7650.

Sincerely,

Linda E. Stiff
Acting Commissioner

Enclosure

Enclosure

Recommendation 1:

Conduct a study to determine whether Medicaid payments can be incorporated in the continuous levy program.

Response:

The FCTC subgroup and the IRS Office of Chief Counsel have completed independent studies and determined that Medicaid disbursements do not qualify as federal payments and therefore cannot be incorporated in the continuous levy program.

Recommendation 2:

Evaluate the 25 referred cases detailed in this report for appropriate additional aggressive collection action and criminal investigation as warranted.

Response:

The IRS will work with your office to secure additional information on the 25 cases identified in your audit with indications of abuse or potential criminal activity. We plan to review each of these case files and refer them for additional action as appropriate.

Appendix IV: Comments from the Centers for Medicare & Medicaid Services

DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: SEP 2 7 2007

TO: Gregory Kutz
Government Accountability Office

FROM: Kerry Weems
Acting Administrator

SUBJECT: Government Accountability Office (GAO) Draft Report: "Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System" (GAO-08-17)

Thank you for the opportunity to review and comment on the subject GAO draft report. The objectives of the report were--(1) to determine if Medicaid providers have unpaid Federal taxes and, if so, the magnitude of such debts; (2) to identify examples of Medicaid providers that have engaged in abusive or criminal activities; and (3) to determine whether the Centers for Medicare & Medicaid Services (CMS) and the States prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay Federal tax debts.

Section 6034 of the Deficit Reduction Act of 2005 (DRA), codified at 42 U.S.C. 1396y-6, established the Medicaid Integrity Program and provided a dedicated appropriation to support the Medicaid Integrity Program's implementation. Although the States are generally responsible for Medicaid program integrity, including provider enrollment, CMS is responsible for implementing the Medicaid Integrity Program. In doing so, CMS strives to improve information sharing among State Medicaid programs and other stakeholders.

Although the draft report includes no recommendations for action by CMS, we are concerned about the tone and language in the draft report that reference, and would imply, certain responsibilities of CMS and the State Medicaid agencies which, under current law, would be inappropriate. We would suggest two approaches to address such concerns: (1) Revise the language, if appropriate, to remove the suggestion of such responsibilities; and (2) Include language in the recommendations section which states that neither CMS nor the States have such responsibilities.

Specific Comments

1. Goals of the Report--The goals of the report, as they are phrased, make implications that are never addressed in the report. For instance, Goal 1 is to "determine if providers who receive Medicaid payments have unpaid Federal taxes, and if so, the magnitude of Federal tax debts owed by these Medicaid providers." As indicated, the goal is to collect information about Medicaid providers that would be relatively objective; however, the implication is that there is some direct correlation between owing taxes and being a Medicaid provider. This implied connection is never evaluated or addressed in this inquiry.

Goal 3 is to "determine whether CMS and selected States prevent health care providers with tax problems from enrolling in Medicaid or participate in the continuous levy program to pay Federal tax debts." Again, although this would appear to be a relatively factual determination, the implication is that there is an underlying connection between the activity (preventing providers with tax problems from participating in the Medicaid program) and the authority and responsibility to perform such activity. In fact, as discussed in the report, the authority is limited, if not precluded by existing law.

2. Continuous Levy Program -- Page 6 of the report states that--

> "A provision of the Taxpayer Relief Act of 1997 authorizes the Internal Revenue Service (IRS) to continuously levy certain Federal payments made to delinquent taxpayers. However, in the 10 years since its passage, IRS has not determined whether Medicaid payments are considered Federal payments and thus subject to the continuous levy program or determine the feasibility of incorporating such payments into the program."

It is clear that the Continuous Levy program is the direct responsibility of the IRS, and as indicated, the IRS has not determined that Medicaid payments fall under the purview of the program. Furthermore, as stated in the draft report, Federal law prohibits disclosure of taxpayer data to CMS and States. Nevertheless, the report implies that the administrators of Medicaid (i.e., CMS and the State Medicaid agencies) should be conducting the indicated activities, despite the fact that the report does not establish any relationship between being a tax delinquent, meeting the requirements of being a Medicaid provider, and receiving Medicaid payments. Further, there is no connection made in the report between the amount of the tax delinquency of the entities (which happens to be Medicaid providers) and the level of Medicaid payments made to such providers.

GAO Recommendation

There were no recommendations made to CMS.

Additional Technical Comments

Apart from comments on the draft report's substantive arguments, CMS notes several typographical/stylistic errors in the report. For instance, page 8 describes CMS as the "Centers for *Medicaid* and Medicaid Services." (Emphasis added.) Additionally, Table 1, designed to highlight Medicaid providers/tax cheats, repeatedly refers to the providers as having received "Medicare" funds.

In conclusion, the report does not make the case for actions by CMS and State Medicaid agencies, and yet leaves the impression that CMS and States should be conducting certain activities even if precluded under current Federal law. We believe that the stated goals for this investigation were based on misconceptions about the authority and responsibilities of the Medicaid program. The language of the report consequently reflected these misconceptions. In this regard, we suggest, at a minimum, that the recommendations of the final version of the report state clearly that neither CMS nor the States have an obligation to screen potential Medicaid providers for unpaid Federal tax debts. Furthermore, the report should be edited to remove any implication that CMS and State Medicaid agencies are in any way responsible for the report's findings.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Greg D. Kutz, (202) 512-6722, or kutzg@gao.gov

Acknowledgments

In addition to the contact named above, the following individuals made major contributions to this report: Matthew Valenta, Assistant Director; Erika Axelson; Ray Bush; Jeremiah Cockrum; Bill Cordrey; Kenneth Hill; John Kelly; Tram Le; Barbara Lewis; Andrew McIntosh; John Ryan; Steve Sebastian; Robert Sharpe; Barry Shillito; Pat Tobo; and Jenniffer Wilson made key contributions to this report.

Report to Senate Committee on Homeland Security and Governmental Affairs
Permanent Subcommittee on Investigations

Levying Medicaid Provider Payments

Background

The Federal Contractor Tax Compliance task force (FCTC) was established in March 2004 in response to concerns raised by the Government Accountability Office (GAO) and the Permanent Subcommittee on Investigations regarding federal contractors who owe delinquent taxes. Among other things, the FCTC looks at ways to improve and expand the Federal Payment Levy Program (FPLP). The FPLP is a program that matches delinquent tax debts with federal payments disbursed by the government, including payments to federal vendors. When a match occurs and all of the requirements for levy have been met, the payment is levied and applied to the tax debt.

The FCTC initially focused on improving the levy of Department of Defense and civilian agency contractors. More recently, the task force turned its attention to finding the most efficient and effective way to levy payments to Medicare providers and suppliers and, as we have previously reported, we are on track to implement a pilot process to levy Medicare payments beginning in October 2008.

A recent GAO report raised the issue of Medicaid providers who owe delinquent taxes, and a hearing on this topic was held by the Subcommittee on November 14, 2007. At that time, the Subcommittee asked each of the agencies present at the hearing to report on the issues and challenges associated with levying Medicaid payments and to make recommendations for overcoming those challenges. This response reflects the input of all three agencies.

Issues/Options

An FCTC subgroup consisting of the Financial Management Service (FMS), the Internal Revenue Service (IRS), and the Centers for Medicare & Medicaid Services (CMS) has begun to examine the issue of how to levy Medicaid payments. This report outlines options that the FCTC is beginning to explore and the issues that have been identified to date. Because states administer the Medicaid program, enroll providers, set state-specific rules and reimbursement rates for providers and health plans, and make payments to the providers and plans, the FCTC subgroup plans to include states in future discussion on levying Medicaid payments for federal tax debt.

Permanent Subcommittee on Investigations
EXHIBIT #2

Enhance the Paper Levy Process for Levying Medicaid Payments

This option would involve the development of a process to match Medicaid providers with the tax debts included in the FPLP and provide the match information to the IRS so that IRS could issue paper levies to state Medicaid agencies responsible for reimbursing providers.

One challenge to this process is that there is not a central registry of Medicaid providers because Medicaid is administered and run by the individual states. The costs and feasibility of establishing such a registry would need to be examined.

Another challenge to this process is that the Internal Revenue Code does not authorize a continuous levy on Medicaid payments, as we explain below. Therefore, unless the paper levy is issued coincident with the issuance of a payment, no collection will result. Legislation would be required to make a levy on Medicaid payments continuous or to extend the time period during which the levy is effective. However, this could result in significant additional costs to the states since compliance with a continuous levy would require states to develop automated processes as discussed in greater detail below.

Include Medicaid Payments in the FPLP

The subgroup initially explored the possibility of including Medicaid payments in the FPLP and determined that this option was not legally available because Medicaid payments are issued by states and are not federal payments. The FPLP was established to implement 26 U.S.C. 6331(h), which authorizes the IRS to continuously levy certain "specified payments." Currently, Medicaid payments to providers are not among the payments included in this authority. Thus, a legislative amendment to expand the list of specified payments would be a prerequisite to including Medicaid payments to providers in the FPLP.

Another significant challenge to incorporating Medicaid payments into the FPLP is state participation. Including Medicaid payments in the FPLP would require states to develop new systems or substantially change existing systems develop file formats compatible with the FPLP and establish connectivity with FMS. There could be significant federal and state costs associated with these requirements and a significant investment of resources, potentially delaying other information-technology priorities.

Next Steps

The work of the FCTC in exploring the issue of levying Medicaid payments will continue and we plan to involve the relevant states agencies in the process to assist in further identifying options and any issues associated with those options. We will keep the Subcommittee apprised of our progress.

Specifically, the FCTC plans to consider the following actions:

1. Conduct a test match between Medicaid data and debt information contained in the FPLP to determine potential collections.

2. Compare available Medicare and Medicaid provider information to determine if significant overlap in providers exists.

3. Continue to work toward implementing a process to levy Medicare payments and determine the impact of this process on the collection of tax debt owed by Medicaid providers.

4. Identify the most cost effective and efficient process that would have the least adverse affect on the states.

Conclusion

As noted above, the FCTC has just begun exploring the complex issue of how to ensure that Medicaid providers meet their federal tax obligations. While we have identified some options and challenges, we anticipate that as the work of the task force continues and more information is obtained, these options will evolve. The FCTC is committed to this process, and we look forward to working together to meet this challenge.

GAO
Accountability * Integrity * Reliability
United States Government Accountability Office
Washington, DC 20548

December 19, 2007

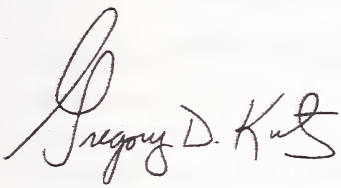
The Honorable Carl Levin
Chairman
The Honorable Norm Coleman
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Subject: *Tax Compliance: Posthearing Responses on November 14, 2007, Hearing on Medicaid Providers That Owe Federal Taxes*

On November 14, 2007, we testified before your subcommittee at the subject hearing. During the hearing, you asked us to provide information regarding (1) whether selected states require providers to disclose whether they owe any federal taxes on their Medicaid applications and whether the selected states deny enrollment to Medicaid if the applicants failed to pay their federal taxes; (2) whether selected states have any policies or legal obstacles that would prevent the states from adding a provider consent statement authorizing the state to determine whether the applicant has any federal tax debts; and (3) what legal, policy, or operational obstacles impede the continuous levy of Medicaid payments for federal tax debts and possible solutions to overcome these obstacles. This correspondence responds to your request for additional information. Our responses are based on discussions with officials from the Internal Revenue Service and the seven selected states from our audit: California, Colorado, Florida, Maryland, New York, Pennsylvania, and Texas.

Permanent Subcommittee on Investigations
EXHIBIT #3

If you have any further questions or would like to discuss these responses, please call John Kelly, Assistant Director, Forensic Audits and Special Investigations, on (202) 512-6926 or Matthew Valenta, Assistant Director, Forensic Audits and Special Investigations, on (214) 777-5697.



Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Enclosure -1

Enclosure

Responses to Questions from the Permanent Subcommittee on Investigations' Hearing on Medicaid Providers That Owe Federal Taxes November 14, 2007

1. **For the seven selected states included in your audit, do these states require providers to disclose whether they owe any federal taxes on the Medicaid provider application? Do any of these selected states deny enrollment into the Medicaid program based on providers owing federal taxes?**

Answer:

Officials from the seven states covered in our audit[1] stated that they do not require disclosure of federal or state tax debts on the Medicaid provider application. In addition, they said that their states do not deny providers entry into the Medicaid program based on delinquent federal or state tax debts.[2] Officials from three states said that they do not have the legal basis to deny providers that owe federal taxes from participating in the Medicaid program without federal law or regulation requiring the states to do so.

Officials from six states expressed concerns regarding any new policy that would require them to screen Medicaid providers for unpaid federal taxes. Their concerns include the possibility that (1) potential providers would be discouraged from participating in the Medicaid program and (2) state Medicaid agencies would be put in the position of enforcing federal tax law instead of providing health care services for low-income people. Officials from two states suggested that it actually might be

[1]The seven selected states were chosen based on magnitude of Medicaid payments and geography. See GAO, *Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System*, GAO-08-17 (Washington, D.C.: Nov. 14, 2007).

[2]Two states, California and Florida, did state that they do screen Medicaid applicants for health care-related debts. Specifically, they screen for fines and debts owed by providers to any federal, state, or local government that relates to Medicare, Medicaid, and other federal and state health care programs.

appropriate to enroll certain providers that owe state debts because their Medicaid payments can be offset to pay the debts owed to the state.

2. **Do any of the seven selected states have any policies or legal obstacles that would prevent the states from adding a provider consent statement authorizing the state to determine whether the applicant has any federal tax debts?**

Answer:

According to officials in all seven states, they are not aware of any policy or legal obstacles that would prevent them from including a consent statement authorizing the state to ask the Internal Revenue Service (IRS) as to whether an applicant has federal tax debt. Several state officials stated that while they do not wish to include any providers that refuse to pay their taxes in their Medicaid programs, they were concerned that this additional consent requirement may discourage providers from participating in Medicaid. Further, officials from several states said that Medicaid providers are not required to renew their participation in the program once they are already approved to participate. Thus, according to those state officials, the requirement to obtain taxpayer consent for those providers that are currently in the Medicaid program would be an extraordinary undertaking, both in terms of human capital and computerized system support requirements.

3. **What legal, policy, or operational obstacles impede the continuous levy of Medicaid payments for federal tax debts? What are possible solutions to overcome these obstacles?**

Answer:

IRS faces legal, policy, and operational obstacles that need to be addressed before it can continuously levy Medicaid payments. For example, according to IRS, Medicaid payments are not federal payments and thus cannot be continuously levied. Thus, IRS and the Federal Contractor Tax Compliance (FCTC) task force will need to develop a

process outside the Federal Payment Levy Program (FPLP) to systematically levy Medicaid payments. In developing a solution, IRS and the FCTC task force may want to model the process after an established process, such as IRS's program for levying state income tax refunds. However, it is important for IRS and the FCTC task force to carefully coordinate the design and implementation of such a process with the states.

Based on our discussions with IRS officials, Medicaid payments do not meet the criteria for federal payments and thus are not subject to the FPLP. Since Medicaid payments are not considered federal payments and thus do not qualify for the continuous levy process, IRS can only levy Medicaid payments through paper levies. According to IRS officials, unlike levies from the continuous levy program, each paper levy is typically a onetime seizure of property (i.e., Medicaid receivables) held by states at a specific point in time. These levies are initiated on a case-by-case basis. Therefore, the paper levy process does not work on a continuous basis and will not be effective for collection purposes.

Officials in all seven states told us that they do not foresee any policy, legal, or operational obstacles at the state level for the collection of delinquent federal tax debts as long as there is statutory or regulatory authority to authorize such actions. Officials from several states said that they had central offset programs for the levy of Medicaid payments for collection of state debts. However, state officials expressed several concerns over the continuous levy of Medicaid payments, including (1) the financial burden such action would place on the Medicaid program without federal funding to support the collection efforts, (2) the potential reduction in the number of providers willing to participate in the Medicaid program, and
(3) the possibility that IRS levies would take priority over claims owed to Medicaid, the states, or both. Further, for a continuous levy program to be properly implemented, officials from several states said that system modifications will be necessary for electronic interaction with IRS for collection action.

IRS officials stated that the FCTC task force will review the issue of how to increase levies of Medicaid payments. According to IRS officials, this issue is complex given

its legal and operational obstacles. For example, for states to levy Medicaid payments, IRS must be able to identify Medicaid providers and establish a process to send the levy to the state. IRS officials stated that the FCTC task force is currently working on incorporating Medicare and other federal payments into FPLP and that it will take some time to work out the issues to include Medicaid payments in an automated levy program.

In developing a model for levying Medicaid payments, IRS and the FCTC task force may want to explore the use of Form 1099 reporting as a means for identifying current Medicaid providers. Each year, state Medicaid agencies are generally required to report income paid to providers on the Form 1099. IRS may be able to use the data from the Medicaid agencies'1099 file to match to IRS records to identify Medicaid providers that owe federal taxes.

In addition, IRS and the FCTC task force may want to explore the use of the IRS State Income Tax Levy Program (SITLP) as a model for electronically issuing levies to states. According to IRS officials, IRS has agreements with 27 states for the electronic offset of state income tax refunds for federal tax debts owed by individuals. Under this program, IRS periodically sends electronic files of tax debtors to the states. Using this file, the states identify state income tax refund recipients that owe federal taxes and levies those payments for the taxes owed. IRS may want to use a similar program to send levies to states for Medicaid payments.

Finally, several states, including Maryland, have stated that they have a central disbursement office for paying all state payments. For those states, IRS may want to consider levying all applicable state payments (e.g., state contractors) rather than focusing on only Medicaid payments. In fact, the Commissioner of the Department of the Treasury's Financial Management Service (FMS) stated that FMS has in place reciprocal agreements with the states of Maryland and New Jersey. Under this pilot program, FMS offsets certain federal payments to collect debts owed to participating states, and in return, state payments are offset to collect federal debt. Since offsets began in July, FMS has collected $11.8 million of debt owed to Maryland and New

Enclosure

Jersey and those states have collected $439,000 of debt owed to the federal government. In discussions with officials from California, they have expressed interest in such a program.

We believe that any process that IRS and the FCTC task force establish to electronically levy Medicaid payments will require careful coordination with the states. Moreover, reciprocal agreements show promise because they benefit both states and the federal government. In our discussions with officials of the seven selected states, we found that no discussions between the federal government and the states have taken place. Such discussions are vital to effectively developing and implementing any solution to increase the levies of federal tax debtors.

We discussed with IRS officials the potential of using programs, such as SITLP and Form 1099 reporting, as models for developing a program to levy Medicaid payments. IRS officials stated that the incorporation of Medicaid payments will be a complex and long-term effort. While IRS officials were receptive to these ideas in developing a process for levying Medicaid payments, they emphasized that IRS' current focus is developing a process for continually levying Medicare and other federal payments.

**COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS HEARING
on
MEDICAID PROVIDERS THAT CHEAT ON THEIR TAXES
AND WHAT SHOULD BE DONE ABOUT IT
NOVEMBER 14, 2007**

This is the answer for the record to be inserted into the transcript for this hearing:

LEAD-IN TO THE QUESTION:

SENATOR LEVIN – Would you have any problem, Mr. Smith, would your agency have any problem requiring States to add a representation on the application of the provider that the provider has no outstanding Federal tax debt?

MR. SMITH – Mr. Chairman, I would have to talk with counsel to see if that would be allowable. The Medicaid statute itself has certain provisions, and if we could require it—I would not have any problem with requiring it if we have the authority.

SENATOR LEVIN – Would you let us know if you have any problem with that?

INSERT: Page 55, line 22

MR. SMITH – The Federal Contractor Tax Compliance task force (FCTC) was established in March 2004 in response to concerns raised by the Government Accountability Office (GAO) and the Permanent Subcommittee on Investigations regarding federal contractors who owe delinquent taxes.

The FCTC initially focused on improving the levy of Department of Defense and civilian agency contractors. More recently, the task force turned its attention to finding the most efficient and effective way to levy payments to Medicare providers and suppliers and, as we have previously reported, we are on track to implement a pilot process to levy Medicare payments beginning in October 2008.

The subgroup initially explored the possibility of including Medicaid payments in the Federal Payment Levy Program (FPLP) and determined that this option was not legally available because Medicaid payments are issued by states and are not federal payments. The FPLP was established to implement 26 U.S.C. 6331(h), which authorizes the IRS to continuously levy certain "specified payments." Currently, Medicaid payments to providers are not among the payments included in this authority. Thus, a legislative amendment to expand the list of specified payments would be a prerequisite to including Medicaid payments to providers in the FPLP.

Permanent Subcommittee on Investigations
EXHIBIT #4

RESPONSE TO SUPPLEMENTAL QUESTION FOR THE RECORD
FROM
SENATOR NORM COLEMAN
to
GREGORY D. KUTZ
Managing Director
Forensic Audits and Special Investigations Unit
U. S. Government Accountability Office

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
MEDICAID PROVIDERS THAT CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT

In your previous work on federal contractors with tax delinquencies among contractors for DOD, GSA, and civilian agencies, is it possible that some contractors appeared in more than one category? Please determine the total number of federal contractors that were identified in these three reviews as well as the total amount of taxes that these contractors owe IRS.

Answer:

In each of our audits and related investigations, we found thousands of federal contractors that owed billions of dollars of federal taxes. Specifically,

- In February 2004, we testified that Department of Defense (DOD) and Internal Revenue Service (IRS) records showed that about 27,000 DOD contractors owed nearly $3 billion in federal taxes.

- In June 2005, we testified that about 33,000 civilian agency federal contractors owed over $3.3 billion in federal taxes.

- In March 2006, we testified that over 3,800 General Services Administration (GSA) contractors owed about $1.4 billion in federal taxes.

Because federal contractors may do business with more than one federal agency, some federal contractors that owe tax debts are likely to be included in more than one analysis concerning DOD, GSA, and civilian federal contractors that abuse the federal tax system.[1] Since our analysis for each segment covered different time periods and our access to taxpayer information on completed reviews is restricted, we cannot provide an overall number of federal contractors with tax debts and the magnitude of such debts.

[1] In addition, such overlap may also exist in our analysis of Medicare and Medicaid providers that abuse the federal tax system.

Permanent Subcommittee on Investigations
EXHIBIT #5

RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
FROM
SENATOR NORM COLEMAN
to
LINDA E. STIFF
Acting Commissioner
Internal Revenue Service
U. S. Department of the Treasury

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
MEDICAID PROVIDERS THAT CHEAT ON THEIR TAXES AND WHAT SHOULD BE DONE ABOUT IT
November 14, 2007

1. **Please describe the circumstances under which IRS would impose a 100 percent levy on a federal payment.**

Response: When a federal payment levy source is identified, an IRS Collection employee might proceed with a paper levy. By serving a paper levy on a federal agency source, the IRS can attach 100 percent of the payment. A drawback to the paper levy is that this type of levy is a one-time attachment and not continuous.

By comparison, if the levy is generated through the automated Federal Payment Levy Program (FPLP), the levy is continuous in nature (i.e., it attaches to future payments without having to reissue the levy), but is generally limited to 15 percent of each Federal payment to which it attaches. Section 6331(h) of the Internal Revenue Code, which authorizes the continuous levy on Federal payments, was amended in 2005 to provide an exception to the 15 percent limitation if the payment is to a vendor providing "goods and services" to the Federal Government. However, because the systems used to pay vendors do not distinguish between payments for "goods and services" and other types of payments, our ability to implement this exception has been extremely limited. Defense Department vendor payments are the only payments levied through the FPLP for 100 percent. Other vendor payments can only be levied through the FPLP up to the 15 percent limitation in the statute. This difficulty in implementing the amended statute could be remedied if the term "property" were used in place of "goods," thus subjecting all vendor payments to the increased continuous levy authority.

If a payment source is identified and the timing of the payment is relatively certain, an IRS employee may choose to serve a paper levy on 100 percent of the payment. If, for example, the timing of the payment is uncertain or a series of payments are at issue, the employee may choose to allow the automated process to levy those payments and continue to pursue other collection avenues.

Permanent Subcommittee on Investigations
EXHIBIT #6

2. **According to FMS officials, numerous taxpayers that received a *Final Notice of Intent to Levy and Notice of Your Right To A Hearing* were removed from the Federal Payment Levy Program before their payments could be levied. Please provide an estimate of the number of tax delinquent taxpayers that received a *Final Notice of Intent to Levy and Notice of Your Right To A Hearing* and were removed from the levy program during fiscal year 2007? What amount of tax was owed by these taxpayers?**

   Response: Every week, the Federal Payment Levy Program (FPLP) both adds accounts that qualify for the program and removes accounts because either the account was resolved by full payment or through an abatement or a case action[1] would prohibit levy action. In FY 2007, we added 6.2 million accounts representing $66.4 billion. During the same time, we removed 5.7 million accounts. Please be aware, that accounts can go in and out of the levy program during this timeframe therefore the figures may reflect duplicate accounts. Of those account removed, 31,000 accounts representing $158 million actually resolved their accounts through a full payment or abatement after they received their Final Notice, but prior to levy. An additional 6,800 accounts, totaling $24 million, were resolved after the levy by full payment or abatement. As of the week of October 22, 2007, the FPLP had 10.4 million total accounts in the program representing $127 billion.

3. **What action(s) would be required to make a paper levy continuous where federal payments are not subject to the Federal Payment Levy Program such as with Medicaid payments? If there are several options that would make paper levies continuous, please describe each option.**

   Response: The source of the of the Service's authority to levy is section 6331(a) of Internal Revenue Code. A levy generally attaches only to property or rights to property that are "fixed and determinable" at the time the levy is made. For example, a levy on a bank account attaches only to the funds currently in the account and does not attach to deposits made after the levy is served. There are two narrow exceptions to this rule. First, section 6331(e) authorizes continuous levies on salary and wage payments from the time the levy is served until it is released. Thus, the levy attaches to future wages even though the wages had not been earned—and there was thus no right to payment—at the time the levy was made. Second, section 6331(h) provides similar authority for certain "specified payments," including many types of payments made by the Federal Government.

   Presumably, Congress has the authority to subject additional types of payments, such as payments made by states, or other property rights, to continuous levy. This could be achieved by amending either of the provisions cited above or by enacting a stand-alone provision.

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[1] Case action prohibiting levy action includes if the account became classified bankruptcy/litigation, installment agreement, offer-in-compromise, unable to pay, Collection Due Process appeals request, return adjustment or claim.

4. **How many paper levies were imposed against Medicaid payments during fiscal year 2007? In general terms, with whom are the levies filed? How much in unpaid taxes were recovered from paper levies on Medicaid payments over the past 5 years?**

   Response: Individual states report to the IRS Medicaid payments to providers in excess of $600. The IRS receives this information from the states via Form 1099. Like other Form 1099 data, this information is available on the IRS's levy database. However, under our traditional paper levy program, the IRS does not track levy information (volume/dollars collected) from specific payment sources. Therefore, we are unable to provide specific numbers to respond to this question.

5. **In IRS' opinion, could state reciprocal tax collection agreements be extended to cover Medicaid payments?**

   Response: As noted at the hearing, enforcement action to capture the property or rights to property of delinquent Medicaid providers must focus on payments by state Medicaid agencies following providers' submission of claims for reimbursement. However, where state agencies routinely pay submitted claims pursuant to a statutory obligation to pay the vast bulk of all claims within 30 days of submission, efficient capture of Medicaid provider payments requires significant allocation of resources to routinely serve paper levies on the state agencies. Coordination between the IRS and state Medicaid agencies, as now occurs under the State Income Tax Levy Program (SITLP), could enhance the efficiency of the IRS collection effort.

   Under the SITLP program, the IRS automatically levies the state income tax refunds of taxpayers that owe a federal tax liability. Currently, there are 27 participating states, with 3 more states to be added by the end of 2008. To participate in this Federal/State program, the state and the IRS execute an agreement where the state agrees to match their refund database against the IRS levy file. The agreement is not reciprocal; however, under a separate program, known as the Treasury Offset Program, federal income tax refunds may be offset to collect state income tax liabilities. Participation in one program, however, is not dependent on participation in the other.

   One immediate challenge to negotiating similar arrangements with states concerning levy of Medicaid proceeds is the absence of a financial incentive or legal requirements for state participation. States that participated in a Medicaid-based program would be obliged to incur certain program expenses to ensure a greater portion of Medicaid dollars are available for levy by the IRS, without the promise of additional receipts flowing to the state by virtue of their participation in the program. Some additional incentive or legal compulsion may consequently be required in order for states to readily enter a reciprocal arrangement with the IRS for collection of the tax debt of Medicaid providers.

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